COST ACCOUNTING STANDARDS, WAIVERS AND COMPLIANCE

HEARINGS

BEFORE THE

JOINT COMMITTEE ON DEFENSE PRODUCTION CONGRESS OF THE UNITED STATES

NINETY-FOURTH CONGRESS

FIRST SESSION

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COST ACCOUNTING STANDARDS, WAIVERS, AND COMPLIANCE

WEDNESDAY, AUGUST 20, 1975

U.S. SENATE,
JOINT COMMITTEE ON DEFENSE PRODUCTION,
Washington, D.C.

The Joint Committee met at 10 a.m., pursuant to call, in room 5302, Dirksen Senate Office Building, Senator William Proxmire (Vice Chairman of the Joint Committee) presiding.

Present: Senators Proxmire and Sparkman.

Senator PROXMIRE. The Joint Committee will come to order.

Today's hearings have been called to inquire into the circumstances surrounding the recent request of the Department of Defense to exempt the United States Steel Corp. from the Government's uniform cost accounting regulations.

The Joint Committee is interested in looking into this request for a waiver, not as an isolated instance, but as a reflection in general of the Defense Department and contractor compliance with the Cost Accounting Standards.

The legislation establishing uniform Cost Accounting Standards and a board to administer them developed in the Senate Banking Committee of which I am chairman and which is kind of a parent committee of the Joint Committee on Defense Production. We had a long fight over these Standards and it took months to get the Banking Committee—and then the Senate and House—to adopt the Cost Accounting Standards legislation and to get the President to sign it into law. But it is now the law of the land.

Admiral Rickover and Elmer Staats, the Comptroller General, played the significant roles in persuading the committee and the Congress to adopt uniform standards. It's interesting that they were the two men that pushed it so hard because some people argue that the uniform standards are detrimental to the Defense Department, detrimental to the defense industry, and detrimental to the national security. Admiral Rickover is an expert on procurement. He is perhaps the most brilliant advocate of effective procurement that the Armed Forces have produced in a long time. Elmer Staats, who was first appointed to high Government office by President Truman, is recognized by us all as a man of great integrity and great competence.

Now why did we adopt the uniform standards? Because we became convinced that the lack of uniformity in reporting costs made it impossible to determine what the costs—especially of military procurement—were to the Federal Government.

Admiral Rickover estimated that this failure to insist on uniform accountability was costing the Government $2 billion a year, and in all of our testimony no one contradicted him.

Obviously it is tempting for defense contractors, on a cost-plus contract or any contract in which costs determine what the Government pays them, to charge as much of their overhead and other costs as they can get away with and without uniform Cost Accounting Standards they can and, in fact, for years did get away with plenty. That defense contractors would resist Cost Accounting Standards that cost them billions and seek waivers if they could get them is as sure and predictable as the morning sunrise.

Whether these Cost Accounting Standards do, in fact, save the taxpayer a billion or two or three a year, they are also essential as a matter of plain and simple fairness among all contractors. Without uniformity some contractors would be treated far better than others. The Standards have brought a degree of integrity to Government procurement that it sorely needed.

Now with this background consider what we are up against in this hearing.

If a company as large and powerful as United States Steel could flatly refuse to comply with the Standards, the precedent would be devastating. The Board and its Standards would be dead.

It is to the great credit of this Board—of all its distinguished members—that they stood up to two of the most powerful institutions in the country, United States Steel and the Department of Defense, and that they refused to waive the Standards and stood fast. I think if we examine the membership of this Board we can see that these aren't a group of all-out liberals or radicals or people who are critical of defense. It consists of Elmer Staats, whom I have already mentioned; Herman Bevis, the former senior partner of Price-Waterhouse, a very distinguished accounting firm; Robert Mautz, partner of Ernst & Ernst, who has a similar background and qualifications in accounting; Terence E. McClary, the Assistant Secretary of Defense (Comptroller); and John M. Walker, of Texas Instruments, a defense contractor.

Let's make it clear this is not a matter of showing disrespect for United States Steel or the Defense Department or of the profit system. The Board consists of five men, all of whom fully recognize the vital importance of profits—good profits for a prosperous defense industry and the necessity of a strong defense industry to our national security.

It is my understanding that, after intensive discussions with the Board, United States Steel has found it possible to comply with uniform Cost Accounting Standards on the contracts at issue. These contracts are vital to the Navy's new submarine programs and I want to congratulate the representatives of United States Steel for the steps they have taken so far toward overcoming their earlier objections to these cost standards. However, as I read the letter, which is the only document that we have indicating compliance, I don't see that it means much and it may mean nothing. I'm going to read it at the conclusion of my remarks in just a minute.

It is important, however, that we make a public record of these developments.

In this same connection, it is my hope also to examine certain of the contract-related programs being undertaken by the Department of Defense under the general heading of "Improving Relations Between DOD and Industry." Included in this package are proposed changes in source selection procedures, manpower reductions in the Defense Contract Audit Agency, accelerated progress payments to industry, faster settlement of contractors' claims, fewer audits of contracts and contract performance, higher dollar thresholds for contracts that may allow contractors to escape statutory labor requirements, and a series of profitability studies to determine whether contractors are making too small a profit.

In these matters, I share the concern of Defense Department officials who wish to avoid undue erosion of our industrial base. Yet we need to be on guard against excessive inflation of our already swollen military budget, and to protect the integrity of our contracts and the defense contracting business.

An objective, equitable, and aboveboard contracting procedure and the industry information which will allow for a fair determination of costs and profits are essential to the safeguarding of the public purse. We need to insure that the current concern for contractor profits in the defense industry is not merely the result of the development of more lucrative profit margins in other markets, especially overseas markets.

Today's hearing will begin with the testimony of Mr. Arthur Schoenhaut, Executive Secretary of the Cost Accounting Standards Board. He will be followed by Dr. John Bennett, Acting Assistant Secretary of Defense for Installations and Logistics, whose office has a primary interest in defense production and in the integrity of the contracting process.

Before you testify, Mr. Schoenhaut, I'd like to read the letter I mentioned earlier because this letter seems to me to leave considerable question as to the extent to which United States Steel has in fact agreed to comply. This is a letter from the Vice President and Comptroller of United States Steel Corp., Mr. B. D. Smith, dated August 15, to Mr. Arthur Schoenhaut, Executive Secretary of the Cost Standards Board.

[Letter follows:]

UNITED STATES STEEL CORP.,
Pittsburgh, Pa., August 15, 1975.

Mr. ARTHUR SCHOENHAUT,
Executive Secretary, Cost Accounting Standards Board,
Washington, D.C.

DEAR MR. SCHOENHAUT: Based upon our extensive discussions with you and the several members of your staff and the DCAA audit representatives in our meetings here in Pittsburgh during the past two days, we are presently of the opinion that our long established standard cost accounting system, as presently constituted and structured, provides the basis for compliance with Cost Accounting Standards at any of our affected profit centers performing contracts or subcontracts to which such standards are applicable and not otherwise excluded or exempted from compliance by applicable law or regulations.

We intend to comply with applicable requirements of the Cost Accounting Standards Board in any appropriate instance where statutory or regulatory exemptions are not available in connection with contracts or subcontracts accepted by U.S. Steel. As we have previously informed you, U.S. Steel has assured Electric Boat that there will be no delay in meeting our delivery promises because of any possible problems in working out the applicability of Cost Accounting Standards.

We appreciate the time and effort expended by you and your associates in meeting with us here in Pittsburgh the last two days and also in our earlier meetings in Washington. We believe our discussions have been very helpful in our having a better understanding of the requirements of these Standards and to the satisfactory resolution of the matter.

Very truly yours,

B. D. SMITH.

Now that letter seems to be an agreement to comply with the Standards. I get the feeling, however, that it's kind of like the recommendation that Senator George Aiken made in the Senate for the benefit of President Nixon or President Johnson at the time that the Vietnam war—I think, as a matter of fact it goes back to 1966 when the war was not going too well. What Senator Aiken said essentially was: "Why don't we simply declare that we won and get out?"

I have a feeling here that what United States Steel has done is say they are not going to do much about their present accounting system or changing their cost methods to make them comply to the uniform system required by the Board because in their view they comply now. Therefore, in their view they are complying and therefore there's no problem. Now I hope that I misunderstand this. I hope that what I have just said is not the case, but I think there's nothing in this letter to indicate that there's going to be an effective compliance by United States Steel.

I would hope this morning, Mr. Schoenhaut, that you can indicate how effective this compliance is and where the teeth are to make sure we have the compliance.

Now if you would introduce the gentlemen who are with you and proceed. As I think you understand, we hope you can confine your remarks to 10 minutes or so and then we can have some questions.

STATEMENT OF ARTHUR SCHOENHAUT, EXECUTIVE SECRETARY, COST ACCOUNTING STANDARDS BOARD, ACCOMPANIED BY HARRY VAN CLEVE, GENERAL COUNSEL, AND WILLIAM PARKER, PROJECT DIRECTOR

Mr. SCHOENHAUT. Thank you, Mr. Chairman.

On my left is Harry Van Cleve, General Counsel of the Board, and on my right is William Parker, a project director for the Board.

We are pleased to appear before you today to discuss the Cost Accounting Standards Board's recent decision to deny the request by the Department of Defense that the Board waive its requirements with respect to five proposed subcontracts to be awarded to the United State Steel Corp. The subcontracts would be awarded by the Electric Boat Division of General Dynamics Corp., a Navy prime contractor for construction of nuclear-powered submarines.

The Cost Accounting Standards Board was established as an agent of the Congress by Public Law 91–379, enacted on August 15, 1970. The Board's primary functions under that law are: (1) To promulgate Cost Accounting Standards designed to achieve uniformity and consistency in the cost accounting principles followed by defense contractors and subcontractors and (2) To develop regulations under which such contractors and subcontractors shall be required, as a condition of contracting, to disclose in writing their cost accounting

practices. Ten Cost Accounting Standards have been promulgated by the Board and two additional proposed standards have been published in the *Federal Register* as exposure rafts for public comment.

In addition, the Board has issued a disclosure statement that must be filed with procurement agencies by those companies which received annual prime contract awards of negotiated defense contracts totaling more than $10 million. The filing requirement was recently extended to cover companies who receive more than $10 million of both negotiated prime contracts and subcontracts during fiscal year 1976.

The Board is authorized to prescribe rules and regulations exempting from the requirements of Public Law 91–379 such classes or categories of defense contractors or subcontractors when it determines, on the basis of size of the contracts involved or for other reasons, that exemption is appropriate. Acting within the scope of this authority, the Board prescribed rules for the submission of requests for waiver of its requirements, recognizing that circumstances could arise when it might be impractical to apply Cost Accounting Standards or to require disclosure of cost accounting practices.

One of the rules pertaining to waiver of Board requirements covering contracts or subcontracts with domestic concerns is set forth in 4 CFR 331.30(c)(1).

In summary, the rule provides that a request for waiver from the relevant Federal agency must be supported by—

(1) An unequivocal statement of the proposed contractor's refusal to accept Cost Accounting Standards:

(2) Information concerning any prior acceptance of the Cost Accounting Standards Contract Clause by the proposed contractor;

(3) Data regarding the dollar amount of the proposed award and other awards during the past 3 years;

(4) A statement that no other satisfactory source is available;

(5) A statement of alternative methods of fulfilling the agency's needs that were considered and the reasons for their rejection; and

(6) A statement of the steps being taken by the agency to establish another source of supply for the future.

These requirements, we believe, tend to make both the prospective contractor or subcontractor and the Government seek agreement on the inclusion of the Cost Accounting Standards Contract Clause in the contract or subcontract being negotiated or to find other means of establishing the reasonableness of prices being negotiated before coming to the Board to obtain a waiver of Board requirements.

I might note here that on two occasions in the past, the Department of Defense—DoD—has urged the Cost Accounting Standards Board to delegate to it the authority to grant waivers on individual contracts on the grounds that such a delegation would permit more expeditious processing of waiver requests. The Board declined to delegate the waiver authority to DoD because it believes it should retain control over a matter as important as total deletion from a contract of the requirement that a contractor comply with Board requirements.

Also, the Board's retention of its waiver authority has not unduly delayed action on waiver requests. The Board has been able to consider and take action on each waiver request by the need date specified in

the request, even though in some cases the procurement situation was urgent. It seems fair to conclude that since the Department of Defense supported the request for the United States Steel waiver, it would have granted the waiver had it the authority to do so. For the reasons that I will discuss, the Board concluded that the granting of such a waiver would be inappropriate.

Because of the restrictions upon the granting of waivers, requests for waiver have been relatively infrequent. In the 4 years that the Board has been operating, 11 waivers have been granted to U.S. domestic contractors and all of these were on contracts of under $1 million. Based on information furnished by the requesting Government agency, each of the waivers granted was judged to be one-time—or at least very infrequent—procurements from the company involved; they involved a procurement from a sole source; and the urgency and essentiality of the procurement precluded any alternative to making the proposed contract.

In addition, there were 32 waivers granted to foreign contractors and foreign governments who objected to following both U.S. regulations and those of the foreign country, and for whom circumstances were cited similar to those cited with respect to domestic contractors; that is, sole source and essentiality of the procurement.

The Board denied nine agency requests for waiver, including the most recent denial of an application for waiver in connection with United States Steel subcontracts, because the need for the waiver had not been fully demonstrated or granting the waiver would set a precedent for substantial departure from the Board's statutory objectives of uniformity and consistency.

It was clear from the Department of Defense waiver request to the Board that United States Steel had unequivocally refused to accept the Cost Accounting Standards Clause in subcontracts with the Electric Boat Division of General Dynamics, the Navy's prime contractor. The stated reasons for a corporate decision that United States Steel would not accept Board requirements are that (1) only one-half of 1 percent of its business is Government related; (2) the imposition of Standards would require *possibly* far-reaching changes to its very elaborate accounting system, "the consequences of which cannot be fully evaluated at this time"; and (3) the Law is unreasonable when applied to this business situation.

Apparently, there was no effort made to analyze the impact or merit of Cost Accounting Standards. It appears that United States Steel concluded that it is satisfied with the accounting practices it has already devised for its commercial business and that the volume of Government business does not justify the possible consequences of complying with Cost Accounting Standards.

Since its inception, the Board has vigorously encouraged the cooperation of all those who might be concerned with the impact of Cost Accounting Standards. The Board has urged industry and others knowledgeable in the area of cost accounting to participate in the Board's research process. There are now more than 1,700 organizations and individuals to which Board questionnaires, proposals, and promulgations are regularly mailed for comment, testing, and evaluation. The assistance of these organizations and individuals constitutes an integral part of the Board's research process.

United States Steel generally has not participated in the Board's research process. To the limited extent that comments have been received, the essence of those comments has been accommodated in Standards and regulations promulgated by the Board. The company has not responded to most of the research questionnaires or exposure drafts of Standards published in the *Federal Register* for comment. Thus, the Board was not in a position to know whether compliance with Cost Accounting Standards would require possibly far-reaching changes to United States Steel's cost accounting system.

In this regard, the Board, by letter dated November 20, 1972, advised United States Steel of its concern about the company's decision not to participate in a research questionnaire seeking information on company practices and views on the use of standard costs in various industries. Companies using continuous-flow manufacturing techniques, which include the use of standard costs, responded to the questionnaire. United States Steel did not respond to the Board's letter of November 20, 1972.

The total amount of United States Steel subcontracts for which a waiver was requested by DoD on July 15, 1975, is almost $7 million. Had the Board granted the waiver, this action would have been the largest dollar volume of contracts that the Board authorized to be performed in the United States without the application of Board requirements. To grant a waiver on these subcontracts would represent a substantial impairment of the Board's basic efforts to assure uniformity and consistency. It seems clear that approval of the waiver would have led to future DoD waiver requests for United States Steel contracts and might well have encouraged waiver requests on behalf of other companies in similar situations. The basic statutory objectives of obtaining increased uniformity and consistency in the pricing, administration, and settlement of negotiated defense contracts and subcontracts would have been seriously undermined. The denial of the waiver request by the Board was, therefore, in consonance with its responsibilities under Public Law 91–379.

Since the Board's July 28 denial of the request for waiver, we have met several times with representatives of United States Steel to discuss acceptance of the Cost Accounting Standards contract clause and compliance with Board requirements. In its July 15 request for waiver, the Department of Defense identified one prime contract for $736,000 with United States Steel which included the contract clause.

However, representatives of United States Steel identified four additional prime contracts and two subcontracts, aggregating about $72.5 million, which were awarded in calendar years 1972 and 1973 and which contained the contract clause.

United States Steel believes that it complied with the Cost Accounting Standards Board requirements then in effect in performing on these contracts. We were also advised by United States Steel that nine additional negotiated subcontractors totaling about $6.2 million were accepted in 1974 and 1975 conditioned on waiver of the contract clause. However, DoD has not requested the Board to waive its requirements for these procurements and the subcontracts should contain the clause.

In our meeting with United States Steel representatives we discussed in some detail United States Steel's cost accounting system at the plants that produce steel for the Department of Defense and whether

that system can be adapted to comply with Cost Accounting Standards. We have been advised by United States Steel that it is now of the opinion that its cost accounting system, as presently constituted, provides the basis for compliance with Cost Accounting Standards at any of its profit centers performing contracts or subcontracts to which such Standards are applicable. Also, United States Steel intends to comply with the Board's Standards, rules, and regulations in those procurements where compliance is required.

That completes our statement, Mr. Chairman. We would be pleased to respond to questions the Joint Committee may have.

[Prepared statement of Mr. Schoenhaut follows:]

STATEMENT OF ARTHUR SCHOENHAUT, EXECUTIVE SECRETARY, COST ACCOUNTING STANDARDS BOARD

We are pleased to appear before you today to discuss the Cost Accounting Standards Board's recent decision to deny the request by the Department of Defense that the Board waive its requirements with respect to five proposed subcontracts to be awarded to the United States Steel Corporation. The subcontracts would be awarded by the Electric Boat Division of General Dynamics Corporation, a Navy prime contractor for construction of nuclear-powered submarines.

The Cost Accounting Standards Board was established as an agent of the Congress by Public Law 91–379, enacted on August 15, 1970. The Board's primary functions under that Law are (1) to promulgate Cost Accounting Standards designed to achieve uniformity and consistency in the cost accounting principles followed by defense contractors and subcontractors and (2) to develop regulations under which such contractors and subcontractors shall be required, as a condition of contracting, to disclose in writing their cost accounting practices. Ten Cost Accounting Standards have been promulgated by the Board and two additional proposed Standards have been published in the *Federal Register* as exposure drafts for public comment. In addition, the Board has issued a Disclosure Statement that must be filed with procurement agencies by those companies which received annual prime contract awards of negotiated defense contracts totaling more than $10 million. The filing requirement was recently extended to cover companies who receive more than $10 million of both negotiated prime contracts and subcontracts during fiscal year 1976.

The Board is authorized to prescribe rules and regulations exempting from the requirements of Public Law 91–379 such classes or categories of defense contractors or subcontractors as it determines on the basis of size of the contracts involved or otherwise that exemption is appropriate. Acting within the scope of this authority, the Board prescribed rules for the submission of requests for waiver of its requirements, recognizing that circumstances could arise when it might be impractical to apply Cost Accounting Standards or to require disclosure of cost accounting practices.

REQUIREMENTS COVERING WAIVER REQUESTS

One of the rules pertaining to waiver of Board requirements covering contracts or subcontracts with domestic concerns is set forth in 4 CFR 331.30(c)(1).

In summary, the rule provides that a request for waiver from the relevant Federal agency must be supported by:

1. An unequivocal statement of the proposed contractor's refusal to accept Cost Accounting Standards.
2. Information concerning any prior acceptance of the Cost Accounting Standards Contract Clause by the proposed contractor.
3. Data regarding the dollar amount of the proposed award and other awards during the past 3 years.
4. A statement that no other satisfactory source is available.
5. A statement of alternative methods of fulfilling the agency's needs that were considered and the reasons for their rejection.
6. A statement of the steps being taken by the agency to establish another source of supply for the future.

These requirements, we believe, tend to make both the prospective contractor or subcontractor and the Government seek agreement on the inclusion of the Cost Accounting Standards Contract Clause in the contract or subcontract being negotiated or to find other means of establishing the reasonableness of prices being negotiated before coming to the Board to obtain a waiver of Board requirements.

I might note here that on two occasions in the past, the Department of Defense (DoD) has urged the Cost Accounting Standards Board to delegate to it the authority to grant waivers on individual contracts on the grounds that such a delegation would permit more expeditious processing of waiver requests. The Board declined to delegate the waiver authority to DOD because it believes it should retain control over a matter as important as total deletion from a contract of the requirement that a contractor comply with Board requirements. Also, the Board's retention of its waiver authority has not unduly delayed action on waiver requests. The Board has been able to consider and take action on each waiver request by the need date specified in the request, even though in some cases the procurement situation was urgent. It seems fair to conclude that since the Department of Defense supported the request for the U.S. Steel waiver, it would have granted the waiver had it the authority to do so. For the reasons that I will discuss, the Board concluded that the granting of such a waiver would be inappropriate.

WAIVERS GRANTED

Because of the restrictions upon the granting of waivers, requests for waiver have been relatively infrequent. In the 4 years that the Board has been operating 11 waivers have been granted to U.S. domestic contractors and all of these were on contracts of under $1 million. Based on information furnished by the requesting Government agency, each of the waivers granted was judged to be one-time—or at least very infrequent—procurements from the company involved; they involved a procurement from a sole source; and the urgency and essentiality of the procurement precluded any alternative to making the proposed contract. In addition, there were 32 waivers granted to foreign contractors and foreign governments who objected to following both U.S. regulations and those of the foreign country, and for whom circumstances were cited similar to those cited with respect to domestic contractors, i.e., sole source and essentiality of the procurement.

WAIVERS DENIED

The Board denied nine agency requests for waiver, including the most recent denial of an application for waiver in connection with United States Steel subcontracts, because the need for the waiver had not been fully demonstrated or granting the waiver would set a precedent for substantial departure from the Board's statutory objectives of uniformity and consistency.

Denial of waiver request involving United States Steel

It was clear from the Department of Defense waiver request to the Board that United States Steel had unequivocally refused to accept the Cost Accounting Standards Clause in subcontracts with the Electric Boat Division of General Dynamics, the Navy's prime contractor. The stated reasons for a corporate decision that United States Steel would not accept Board requirements are that (1) only ½ of one percent of its business is Government related; (2) the imposition of Standards would require *possibly* far-reaching changes to its very elaborate acounting system, "the consequences of which cannot be fully evaluated at this time"; and (3) the Law is unreasonable when applied to this business situation. Apparently, there was no effort made to analyze the impact or merit of Cost Accounting Standards. It appears that United States Steel concluded that it is satisfied with the accounting practices it has already devised for its commercial business and that the volume of Government business does not justify the possible consequences of complying with Cost Accounting Standards.

Since its inception, the Board has vigorously encouraged the cooperation of all those who might be concerned with the impact of Cost Accounting Standards. The Board has urged industry and others knowledgeable in the area of cost accounting to participate in the Board's research process. There are now more than 1,700 organizations and individuals to which Board questionnaires, proposals, and promulgations are regularly mailed for comment, testing and evaluation. The assistance of these organizations and individuals constitutes an integral part of the Board's research process.

United States Steel generally has not participated in the Board's research process. To the limited extent that comments have been received, the essence of those comments has been accommodated in Standards and regulations promulgated by the Board. The company has not responded to most of the research questionnaires or exposure drafts of Standards published in the *Federal Register* for comment. Thus, the Board was not in a position to know whether compliance with Cost Accounting Standards would require possibly far-reaching changes to United States Steel's cost accounting system. In this regard, the Board, by letter dated November 20, 1972, advised United States Steel of its concern about the company's decision not to participate in a research questionnaire seeking information on company practices and views on the use of standard costs in various industries. Companies using continuous-flow manufacturing techniques, which include the use of standard costs, responded to the questionnaire. United States Steel did not respond to the Board's letter of November 20, 1972.

The total amount of United States Steel subcontracts for which a waiver was requested by DoD on July 15, 1975, is almost $7 million. Had the Board granted the waiver, this action would have been the largest dollar volume of contracts that the Board authorized to be performed in the United States without the application of Board requirements. To grant a waiver on these subcontracts would represent a substantial impairment of the Board's basic efforts to assure uniformity and consistency. It seems clear that approval of the waiver would have led to future DoD waiver requests for United States Steel contracts and might well have encouraged waiver requests on behalf of other companies in similar situations. The basic statutory objectives of obtaining increased uniformity and consistency in the pricing, administration and settlement of negotiated defense contracts and subcontracts would have been seriously undermined. The denial of the waiver request by the Board was, therefore, in consonance with its responsibilities under Public Law 91–379.

Since the Board's July 28 denial of the request for waiver, we have met several times with representatives of United States Steel to discuss acceptance of the Cost Accounting Standards contract clause and compliance with Board requirements. In its July 15 request for waiver the Department of Defense identified one prime contract for $736,000 with United States Steel which included the contract clause. However, representatives of United States Steel identified four additional prime contracts and two subcontracts, aggregating about $72.5 million, which were awarded in calendar years 1972 and 1973 and which contained the contract clause. United States Steel believes that it complied with the Cost Accounting Standards Board requirements then in effect in performing on these contracts. We were also advised by United States Steel that nine additional negotiated subcontracts totaling about $6.2 million were accepted in 1974 and 1975 conditioned on waiver of the contract clouse. However, DoD has not requested the Board to waive its requirements for these procurements and the subcontracts should contain the clause.

In our meetings with United States Steel representatives we discussed in some detail United States Steel's cost accounting system at the plants that produce steel for the Department of Defense and whether that system can be adapted to comply with Cost Accounting Standards. We have been advised by United States Steel that it is now of the opinion that its cost accounting system, as presently constituted, provides the basis for compliance with Cost Accounting Standards at any of its profit centers performing contracts or subcontracts to which such Standards are applicable. Also, United States Steel intends to comply with Board's Standards, rules, and regulations in those procurements where compliance is required.

That completes our statement, Mr. Chairman. We would be pleased to respond to questions the Committee may have.

Senator PROXMIRE. Mr. Schoenhaut, would you tell the Joint Committee who in general is responsible for monitoring compliance with the Cost Accounting Standards?

Mr. SCHOENHAUT. Yes, sir. The basic audit is made by the Defense Contract Audit Agency, and the General Accounting Office will, from time to time, review the adequacy of the audit made and the enforcement of Standards by the procurement officials of the Defense Department.

Senator PROXMIRE. Now, does the Cost Accounting Standards Board require or have the authority to require any reports on compliance with Cost Accounting Standards?

Mr. SCHOENHAUT. Yes, sir. We have asked the Government agencies involved to report to us annually as of the close of each calendar year, on the effectiveness of Standards and whether they have any suggestions for improvement to those Standards.

Senator PROXMIRE. Does the Board have any information on which contracts contain Cost Accounting Standards and which do not? Or does the Board keep records on which contracts should contain Cost Accounting Standards and which should not?

Mr. SCHOENHAUT. We get copies of a report that is produced by the Defense Department that shows which prime contracts that have been negotiated should contain the Cost Accounting Standards clause. Unfortunately, the Government doesn't have very much information on which subcontracts should contain the clause.

Senator PROXMIRE. You see, one of the difficulties, I think, to the committee, the public, and the taxpayer, is that it seems that the Defense Department, at least in this particular case, and I am sure in other cases, too, doesn't have the same affection for Cost Accounting Standards and uniformity as you do, or it would seem to me, as the law requires. What I am trying to say is that the Defense Department is soft on enforcing the Cost Accounting Standards.

I am just wondering if you have the capacity to determine whether or not that enforcement is accurate and consistent?

Mr. SCHOENHAUT. Yes, sir, Mr. Chairman. The Defense Department and all other agencies that are applying Cost Accounting Standards report to us in these annual reports on violations of the Standards and the disclosure requirement.

Senator PROXMIRE. Are you confident that their report is complete and accurate and you can rely on it?

Mr. SCHOENHAUT. I would think that the report of violations is probably correct, to the best of their ability. The solutions to some of these violations or settlement of the violations is somewhat more obscure. For example, in the reports received for calendar year 1974, the Defense Department reported that there were 92 contractors who failed to follow their disclosed accounting practices and there were 423 violations of promulgated Standards. Now it is unclear what disposition was made of those violations. (See exhibit 12, p. 192.)

Senator PROXMIRE. What is unclear?

Mr. SCHOENHAUT. We don't know what disposition was ultimately made of those violations. There were a large number of violations and we are trying to get the Defense Department to tell us what the situation is with respect to settling those violations. Were they indeed violations?

Senator PROXMIRE. Why should there be any problem? Why shouldn't the Defense Department simply tell you?

Mr. SCHOENHAUT. There is often disagreement between the Defense Department and the contractor on whether in fact there has been a violation and there is also disagreement on what the cost impact of a violation might be. These are the kinds of items that are being negotiated between the two.

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Senator PROXMIRE. This law was passed 5 years ago. What does the record show on the violations and on enforcement?

Mr. SCHOENHAUT. The record shows——

Senator PROXMIRE. You tell us there is a large number of violations, but you don't know what disposition is made, what effective enforcement is achieved?

Mr. SCHOENHAUT. That's correct.

Senator PROXMIRE. Shouldn't we just require a change in the law so that you have that information, so you do know?

Mr. SCHOENHAUT. Well, the Defense Department recently issued a regulation that we think may well accomplish getting some of these violations resolved and determining the cost impact that might be involved. They are now requiring within certain time frames, that contractors furnish them with the cost impact of reported violations and the administrative contracting officer in each case is supposed to make a determination of whether he agrees there was a violation or not and whether he agrees with the cost impact statement.

Senator PROXMIRE. What penalties are there for violations?

Mr. SCHOENHAUT. Refund to the Government of any excess payments on a particular contract with interest not to exceed 7 percent.

Senator PROXMIRE. That is a pretty mild penalty, these days, with the prime rate at 7½ percent. It is a pretty good deal. It seems to me there is a strong incentive for violating.

Mr. SCHOENHAUT. That is the penalty provision in the law. It is really not a penalty, Mr. Chairman.

Senator PROXMIRE. Who makes the final determination of the violation?

Mr. SCHOENHAUT. The administrative contracting officer.

Senator PROXMIRE. The Defense Department does?

Mr. SCHOENHAUT. Yes, sir. On the basis of—well, he considers the recommendations of a Defense Contract Audit Agency audit report.

Senator PROXMIRE. At the very least, it seems to me you should have the full information so that you know what the disposition of these violations is, that we have a record of it, and we know about it. Secondly, I would also feel that we ought to very seriously consider whether or not we ought to increase the penalties. Thirdly, I think there is some question as to whether or not the Defense Department, in the present circumstances, should have the full enforcement capability or whether there shouldn't be some way of seeing penalties are being enforced.

Let me get into the United States Steel situation. I read that letter. As I say, I think that letter leaves a lot of blanks.

What does this agreement in the letter pledge the United States Steel to do in specific terms? What are they obliged to do?

Mr. SCHOENHAUT. They agree that their system can be adapted to comply with Standards and they agree they will comply with Standards wherever they are required.

Senator PROXMIRE. Well, does that satisfy you?

Mr. SCHOENHAUT. Yes, sir. We listened to them. This was the first time that we learned very much about what the United States Steel Corp. does. Based on the explanations they gave us, and based on our explanations to the United States Steel representatives as to what is required by Standards, they felt they could comply.

Senator PROXMIRE. Now does this mean that they will have to make their reports on their specific costs, the proportion of overhead that is applicable and their other elements of cost, in accordance with your own requirements, and that they will make such reports?

Mr. SCHOENHAUT. Yes, sir. They have a very sophisticated standard cost accounting system that is readily adaptable to almost all of the requirements we have issued. There will be some minor changes, I think, that they may have to make and they consider them minor.

The important thing here is that I think United States Steel didn't understand what is required by these Standards and how readily their system could adapt to the Standards. The outgrowth of this should be that United States Steel will furnish cost and pricing data to the Defense Department on these subcontracts——

Senator PROXMIRE. Let me just interrupt to say I don't understand why United States Steel, with its very great capability, didn't understand this. They have been operating under these Standards for several years. We have all kinds of cases in which, as we are going to point out in a minute, in which United States Steel has been subject to these Standards. Five years now this has been the law of the land. Why don't they understand this?

Mr. SCHOENHAUT. Well, it's been our experience, Mr. Chairman, with some companies, that until we have an opportunity to sit down with them and explain the Standards and review their system with them, that they just think they can't comply, that major revisions will be required.

Senator PROXMIRE. Over all these years, has United States Steel taken the position that you should not sit down with them to explain this situation to them?

Mr. SCHOENHAUT. Yes, sir. United States Steel, was what I would characterize as wholly uncooperative until very recently.

Senator PROXMIRE. By "very recently," you mean this letter of August 15 or the discussions in the last few weeks just before that letter?

Mr. SCHOENHAUT. Yes, sir. I think as a consequence of the Board's denial and the interest of this committee, United States Steel was willing to sit down and talk with us.

Senator PROXMIRE. Until that time, with all the contracts they had—it is a small part of their business, but still it is a large number of contracts and a substantial amount of money—they simply had taken the position that there was no way they could comply with their complicated accounting system?

Mr. SCHOENHAUT. That's correct.

Senator PROXMIRE. Then you sat down with them in the last couple weeks; now they find there is no real problem?

Mr. SCHOENHAUT. That's correct.

Senator PROXMIRE. And you are satisfied that is the case?

Mr. SCHOENHAUT. Based on what they told us, I am satisfied that is the case.

Senator PROXMIRE. Now have other steel companies acted the same way?

Mr. SCHOENHAUT. Generally not. One steel company has not commented very extensively on any of our proposals. Another one has commented on almost every proposal. I think it varies, Mr. Chairman.

Senator PROXMIRE. Then United States Steel has rejected Cost Standards out of hand without inquiring into them; is that right?

Mr. SCHOENHAUT. This is how I would characterize it; yes, sir.

Senator PROXMIRE. Now they say "We intend to comply with applicable requirements of the Cost Accounting Standards Board in any appropriate instance where statutory or regulatory exemptions are not available in connection with contracts or subcontracts accepted by United States Steel."

Who determines what is an "appropriate instance"? Would they or would you or would the Defense Department?

Mr. SCHOENHAUT. The Defense Department would make the determination.

Senator PROXMIRE. And the Defense Department wanted a waiver before. Are we vulnerable to a decision by the Defense Department that it wouldn't be "appropriate" to comply with Cost Accounting Standards, and under those circumstances, would they find an exemption or an effective waiver?

Mr. SCHOENHAUT. I am not sure what the Defense Department would do, Mr. Chairman. The law has two basic exemptions in it. The contracts and subcontracts are exempt if the prices are based on substantial sales to the public—catalog or market prices of items sold in substantial quantities to the general public.

The other exemption is that the price of the contract or subcontract is set by law or regulation.

Senator PROXMIRE. So you think that that is so clear and obvious and distinct that there is no problem, at least in knowing whether compliance was secured or not; is that right?

What I am concerned about is that the way this letter reads, I have the feeling, as I tried to say in my opening remarks, United States Steel might simply say, "We are complying," and then not comply.

Mr. SCHOENHAUT. We had no reason to believe that, Mr. Chairman. Based on our discussion with them, it was clear that they can comply wherever they are required, and that they will comply wherever they are required to do so.

Senator PROXMIRE. All right. I have more questions.

Senator Sparkman.

Senator SPARKMAN. Thank you very much. I am sorry I was not here for your opening statement, but I have read it. It seems to be a very clear, persuasive presentation. I must confess that I am somewhat confused about this.

Now, Mr. Schoenhaut, do I understand that your statement is to the effect that you think the relationship between your bureau and United States Steel now is in a good condition?

Mr. SCHOENHAUT. Yes, sir. They were most cooperative when we finally got them to sit down and talk with us.

Senator SPARKMAN. And you are agreeable with the letter that the chairman referred to? You think that clearly states the situation?

Mr. SCHOENHAUT. The way I would interpret the letter is that they will comply wherever required by law and that they will have no problem in complying.

Senator SPARKMAN. Well, now, when you say "when required by law," are there exemptions or waivers in the law, or is it supposed to be applicable to everybody?

Mr. SCHOENHAUT. It is supposed to be applicable to everybody, but the law does grant the Board authority to consider giving waivers or exemptions for certain classes and categories of contracts.

Senator SPARKMAN. But that would be determined by your Board?

Mr. SCHOENHAUT. Yes, sir.

Senator SPARKMAN. Did I understand you to say that the Defense Department at times exempts them on certain contracts? How can they do that without referring it to the Board?

Mr. SCHOENHAUT. The law also contains a statutory exemption that a contractor or subcontractor can be exempted from Standards if the price is based on catalog or market prices for sales in substantial quantities to the public.

Also, advertised bid procurements would be exempt and not covered by the Standards.

Senator SPARKMAN. Well, do these cases in which United States Steel did not cooperate with you in the past come under that exemption in the statute?

Mr. SCHOENHAUT. The Navy tells us that those orders did not come under the exemption in the statute. We have been able to piece together now that there are some 19 orders in all for HY-80 steel, totaling about $18,400,000 that were placed by the General Dynamics Corp., that should have contained the Cost Accounting Standards clause. The orders were accepted by United States Steel, conditioned on the Defense Department obtaining a waiver of compliance with Standards.

Senator SPARKMAN. Well, did the Defense Department obtain such waivers?

Mr. SCHOENHAUT. No, sir. The first request we received was for the five waivers that we addressed in our statement.

Senator SPARKMAN. Well, thank you very much.

Senator PROXMIRE. Mr. Schoenhaut, in the view of the Board, as you understand it, was there any deficiency in the request for the waivers submitted by the Department of Defense on behalf of United States Steel? Did it meet adequately all the criteria which you set forth for such a request in your written testimony?

Mr. SCHOENHAUT. Yes, sir. It met the regulation precisely.

Senator PROXMIRE. Now what responsibility does the Defense Department have in reviewing the merits of the contractor's request for a waiver from Cost Accounting Standards requirements? Should such a review include a thorough investigation of all the prior contracts when a manufacturer requests a waiver?

Mr. SCHOENHAUT. I would think so. We have a requirement that they furnish us data on what the situation has been with respect to the contract awards made in the prior 3 fiscal years.

Senator PROXMIRE. Now the reason I asked that is in your written statement you mentioned a number of prime military contracts of United States Steel which the firm alleges contained the Cost Accounting Standards clause. I believe the dollar volume for these contracts in fiscal years 1972 and 1973 was $73 million, roughly. The Defense Department waiver request identifies a single United States Steel Corp., contract containing a Cost Accounting Standards clause, yet in its December letter refusing to sign a contract with Electric Boat Co., the steel company said, and I quote, "We have not accepted any contracts containing the Cost Accounting Standards clause." And that it has,

and I quote, "consistently taken this same position with respect to contracts."

There seems to be a clear conflict on the facts. Did, in fact, United States Steel accept the Cost Accounting Standards clause in the past or not, with the one exception you made?

Mr. SCHOENHAUT. They advised us that they did and, as I just indicated to Senator Sparkman, based on information supplied by United States Steel and information gathered by the Defense Contract Audit Agency, we have now identified 19 orders for steel totaling about $18,400,000 that were accepted by United States Steel, on the condition that a waiver request would be sought by the Defense Department and obtained.

Senator PROXMIRE. That is what I expected you to respond, but I'd like you to explain, if you can, or help me understand, if possible—we have the president of United States Steel testifying here tomorrow and he, of course, will be the man to answer that question, but maybe you can help us get a better understanding before he answers about the assertion in this December letter that United States Steel has not accepted any contracts containing the Cost Accounting Standards clause. Is that just a misstatement?

Mr. SCHOENHAUT. I would think so, based on the information given to us by United States Steel. We have no direct knowledge ourselves. We haven't looked at any of these contracts.

Senator PROXMIRE. There is no way you can characterize these contracts that we have referred to, as not having a Cost Accounting Standards clause? They all have the Cost Accounting Standards clause; is that correct?

Mr. SCHOENHAUT. That is what United States Steel told us, yes, sir.

Senator PROXMIRE. Although in the letter they deny it?

Mr. SCHOENHAUT. Well, I think you are reading from the Defense Department letter, if I am correct. The letter from the Defense Department——

Senator PROXMIRE. I am referring here to a letter by United States Steel refusing to sign a contract with Electric Boat, and the steel company itself in that letter said, and I quote, "We have not accepted any contracts containing the Cost Accounting Standards clause."

Mr. SCHOENHAUT. We don't have that letter, Mr. Chairman.

Senator PROXMIRE. I have the letter here. It is dated December 13, 1974. It is signed by Mr. H. C. Haase, Vice-President of Staff Services-Accounting, of United States Steel Corp. He says, and I quote:

> As further clarification of our position regarding nonacceptance of the Cost Accounting Standards clause, we have not accepted any contracts containing the Cost Accounting Standards clause and the requirement to file cost accounting disclosure statements. We have consistently taken this same position with respect to requests for inclusion of the Cost Accounting Standards clause and Disclosure Statement requirements in subcontracts placed by other customers under government prime contracts as well as under prime contracts placed directly by other Government agencies such as the Defense Construction Supply Center, Aberdeen Proving Grounds and others. (Complete letter, p. 126.)

This is a letter by the United States Steel Corp., not the Defense Department, and this was their assertion on December 13, 1974.

Mr. SCHOENHAUT. We don't have that letter. The Defense Department identified one contract by the American Bridge Division of

United States Steel which had accepted the clause and I thought that was what you were reading from.

Senator PROXMIRE. At any rate, that assertion is contradicted by the facts which you firmly believe?

Mr. SCHOENHAUT. It is contradicted by the facts we obtained from United States Steel during our visit in Pittsburgh. Again, we have no direct knowledge of what is in those contracts.

Senator PROXMIRE. Now, you knew in advance from the Defense Department, I take it, of the prior acceptance by United States Steel of the Cost Accounting Standards clause; is that right?

Mr. SCHOENHAUT. In one prime contract.

Senator PROXMIRE. But only in one prime contract?

Mr. SCHOENHAUT. Yes, sir.

Senator PROXMIRE. Should not the Defense Department assert any prior cases of acceptance and bring them to your attention before forwarding a waiver request?

Mr. SCHOENHAUT. Yes, sir. That is a specific requirement of our regulation.

Senator PROXMIRE. Well, the Defense Department then did not comply with that requirement; is that right?

Mr. SCHOENHAUT. That is right, sir.

Senator PROXMIRE. Have they made any explanation to you as to why they didn't comply?

Mr. SCHOENHAUT. No. We met with them last week, I believe it was, and asked them to tell us what the situation was with respect to all negotiated prime contracts and subcontracts awarded since October 1, 1972, which is the date on which the Cost Accounting Standards contract clause first had to be included in these contracts and subcontracts. The only information we have been able to get is some information furnished by the Defense Contract Audit Agency which I referred to earlier which, when taken with the information supplied by United States Steel, indicates that there are now 19 orders for steel for Electric Boat Co. totaling $18,400,000 that do not include the clause.

Senator PROXMIRE. When did you find out about these 19 orders from the Defense Department?

Mr. SCHOENHAUT. Some of the information came from United States Steel when we were in Pittsburgh. We asked them to identify them, and then some of the information came to us yesterday from the Defense Contract Audit Agency.

Senator PROXMIRE. Have waivers been sent over to the cost accounting standards board for these 19 orders?

Mr. SCHOENHAUT. No, sir.

Senator PROXMIRE. Now this seems very troublesome to me in view of the fact that the Defense Department will have the job of assuring compliance with this agreement, and in view of the fact that the Defense Department submitted its original waiver request without investigating its merits. Are not we back where we started on this issue? What assurance do we have that the Defense Department will not just accept at face value any contracting claim for relief from Cost Accounting Standards?

Mr. SCHOENHAUT. The only way they can make the case for relief is to document a case of an exemption under the provision in our law.

Senator PROXMIRE. Well, yes, but they were supposed to provide you with this information before and didn't do it; is that correct or not?

Mr. SCHOENHAUT. That is correct.

Senator PROXMIRE. How do we know they won't follow the same course in the future? What I am saying is in this case, I don't want to be unfair to the Defense Department—and Mr. Bennett of the Defense Department is going to testify this morning right after you—but it seems to me the Defense Department is kind of a patsy in this case. We don't have an awful lot of confidence in their enforcing the law on the basis of the record that has been made so far this morning with respect to this particular matter.

Do you have any suggestions as to what we could do about that?

Mr. SCHOENHAUT. I think the best thing that perhaps can be done would be for this committee to ask the General Accounting Office to review the situation with respect to United States Steel and get them to report to the committee on anything that has happened in the past or anything that might happen in the future.

Senator PROXMIRE. It is an excellent suggestion. We will follow up on it. Have you any information as to why the request for a waiver from Cost Accounting Standards took so long to reach the Board after it was first filed by United States Steel? They filed this request, I understand, in December of last year and apparently it reached the Board only in mid-summer.

Mr. SCHOENHAUT. They told us in Pittsburgh that they filed the request back in May 1974.

Senator PROXMIRE. May. That is even worse. They filed it more than a year before you got it?

Mr. SCHOENHAUT. That is correct. We got it, I think, on July 14 and were asked to come to a decision by the end of the month.

Senator PROXMIRE. And you did?

Mr. SCHOENHAUT. Yes, sir.

Senator PROXMIRE. So the holdup in this whole thing has been in the Defense Department?

Mr. SCHOENHAUT. Either the Defense Department, Electric Boat, or United States Steel; I don't know where the holdup was.

Senator PROXMIRE. You tell us, based on what they told you, and assuming what they said is correct, that in May United States Steel made a request for a waiver. It was at the latest in December. At any rate, there was a long holdup in the Defense Department?

Mr. SCHOENHAUT. United States Steel also told us there were some defects in the information supplied by the Defense Department to us concerning the situation with respect to United States Steel.

Senator PROXMIRE. Now from your written testimony, there emerges what looks to me like a settled United States Steel policy of noncooperation with the Cost Accounting Standards Board. The Defense Department waiver request also details a continuing problem with this particular contractor, especially with regard to cost and pricing data under the Truth-in-Negotiations Act?

Could you give us some further picture, from your vantage point as Executive Secretary of the Board, as to this steel company's cooperation with the Board as to matters aside from the one at hand?

Mr. SCHOENHAUT. We have no knowledge with respect to anything else except Cost Accounting Standards, Mr. Chairman.

Senator PROXMIRE. You don't have any knowledge on Truth-in-Negotiations?

Mr. SCHOENHAUT. As we testified, United States Steel did fail to respond to our request for completion of questionnaires and to comment on exposure drafts and the like, but it is all in connection with Cost Accounting Standards.

Senator PROXMIRE. In view of that uncooperative attitude that you have cited, what assurance do you have that we won't meet the same problem again in the future on new contracts or contract renewals? It is true that they now have sat down with you for the first time. It is true they indicate they are going to comply, but on the basis of their record, what likelihood is it that there will be cooperation?

Mr. SCHOENHAUT. Only their verbal agreement to cooperate. We recently cited to the representatives of United States Steel their lack of cooperation in the past and how they could indeed benefit from cooperating. It is very hard to write these Cost Accounting Standards in a way that would preclude an administrative nightmare if the companies won't tell you what they are doing. We made that point clear to United States Steel, and I think they understand it.

Senator PROXMIRE. That is an excellent point. Nothing is more frustrating for a business than to have an accounting procedure you have to comply with which is complex and time consuming and difficult, and it is bound to be that way unless all parties cooperate and sit down and work these things out so they thoroughly understand each other.

To your knowledge, what is the status as of today of the five subcontracts that were the subject of the waiver request? Has United States Steel now signed these subcontracts with the Electric Boat Co.? Do you anticipate they will do so? Will the contracts require any modification of the Cost Accounting Standards contract clause before signature?

Mr. SCHOENHAUT. Our understanding when we left Pittsburgh was that they would have no trouble signing the subcontracts with the inclusion of the Cost Accounting Standards clause. There was a problem on one of the subcontracts with the specifications for air flasks. According to United States Steel, they hadn't received the Navy specifications for these air flasks, but except for that problem——

Senator PROXMIRE. So it will be awaiting specifications?

Mr. SCHOENHAUT. Yes, sir.

Senator PROXMIRE. That was on one of the five contracts?

Mr. SCHOENHAUT. Yes, sir. And as soon as we got back from Pittsburgh, we called the Defense Department and asked them to go ahead and try to process the procurements, and our understanding is that they are trying to process the procurements.

Senator PROXMIRE. So, as far as you know, it is proceeding in good order. Will you be notified when the contracts are signed?

Mr. SCHOENHAUT. I guess not, sir.

Senator PROXMIRE. Well, we will do our best to see that the committee is notified.

Do you have any notion of how long it would take United States Steel to comply with the Cost Accounting Standards in the case of these five subcontracts?

Mr. SCHOENHAUT. Well, at the beginning of our discussions with them, they thought it would take them 12 to 18 months to convert their system to comply. We told them that we thought it might take more like 12 to 18 days. Based on our discussions with them, we think we were right, that it will not take very long at all.

Senator PROXMIRE. Then the widespread reports of a heavy administrative burden resulting from Cost Accounting Standards seem to have little basis in fact. If the time-to-comply period will be as brief as you believe—12 to 18 days—doesn't that suggest that no serious effort was ever made by the firm to investigate the implications of compliance for its accounting practices?

Mr. SCHOENHAUT. I think that's correct, Mr. Chairman. Based on our discussions with them, they didn't really know what we require.

Senator PROXMIRE. It looks like a smokescreen to simply avoid making the reports on their costs and their profits.

In connection with the contracts for which waivers were formally requested, was shipment of the products required held back or halted at any time on any of the contracts?

Mr. SCHOENHAUT. United States Steel told us that they never stopped producing and shipping the steel and making all the delivery dates, and based on the discussions with them and the people from the Navy, that is probably correct.

Senator PROXMIRE. That is reassuring.

There was no hold up, then, no delay in the delivery of the steel?

Mr. SCHOENHAUT. This was what we were told and the Navy agreed with that.

Senator PROXMIRE. If the key factor in initiating a waiver request is a manufacturer's refusal to accept Cost Accounting Standards, how unequivocal does this refusal have to be? For example, if a company accepts the Cost Accounting Standards clause on some contracts, refuses to accept it on others, and continues to deliver the goods without any contract in other cases, doesn't that puncture the notion of adamant rejection? This would seem to be the case in the United States Steel Corp.

Mr. VAN CLEVE. Yes; I think it would, Mr. Chairman. Our regulation requires that the refusal has to be unqualified. Where the company has already accepted the clause in prior contracts, it seems to me very hard to say that there is an unqualified refusal. They have surely accepted the clause in prior contracts, it seems to me very hard to say that there is an unqualified refusal. They have surely accepted the clause and complied with Standards in some cases. When they come along later on and say they don't intend to now under any circumstances whatever, I think we have to ask the question whether they could not, in fact, comply in the future as they have done in the past.

Senator PROXMIRE. I think that is a good point. It is particularly appropriate here where the only reason given, the principal reason, at least—by United States Steel for not complying is that they had an elaborate accounting system, which made it very hard to use the kind of standard you have.

Now, if they can do it in several cases—and we have developed the fact that they appear to have done so; at least they have had the Cost Accounting Standards clause in their previous contracts—it is very difficult to understand why they can't do it in this case.

Mr. VAN CLEVE. Yes, sir.

Senator PROXMIRE. Now you mention in your written statement, Mr. Schoenhaut, cases where you have granted exemptions to the CAS clause for compelling reasons. Are there currently before the Board any pending requests for waivers or exemptions? If so, would you tell us about them, briefly?

Mr. SCHOENHAUT. Yes, sir. We have a request for exemption from the Aluminum Co. of America and we have a meeting with them on September 11 to see if there isn't some misunderstanding on their part as to what is required by these Standards and whether they can readily comply with the Standards.

Senator PROXMIRE. How big a contract is this, roughly?

Mr. SCHOENHAUT. Well, it would be a total exemption for all their business, most of which is subcontract business, and I don't know the amount of dollars that might be involved.

Senator PROXMIRE. This is a total exemption for all their business?

Mr. SCHOENHAUT. Yes, sir. But please understand, Mr. Chairman——

Senator PROXMIRE. Is this on the grounds they do a small part of their business with the Government and that their accounting system is complex, which were the grounds that United States Steel cited?

Mr. SCHOENHAUT. Yes, sir; essentially the same grounds. But they have accepted Standards, as we understand it, and accepted the clause in every contract where they have been required to accept them.

Senator PROXMIRE. So they have accepted Standards in the past?

Mr. SCHOENHAUT. Yes, sir.

Senator PROXMIRE. Yet they are asking a waiver now?

Mr. SCHOENHAUT. They believe that there are some administrative problems with complying with some of the Standards that have been promulgated by the Board and they believe that there will be many more problems in complying with future Standards.

Senator PROXMIRE. Did the Defense Department support that request for a waiver?

Mr. SCHOENHAUT. Not yet, sir. It is a request for an exemption that comes direct from the company to the Board and does not have to go through the Defense Department. We have now gone back to the Defense Department to try to find out whether they know whether ALCOA was a sole source in any particular procurement or whether they may be a sole source of future procurements and whether or not they support the request for exemption.

Senator PROXMIRE. Did ALCOA cite United States Steel as a precedent in any way?

Mr. SCHOENHAUT. No, sir.

Senator PROXMIRE. No argument that if United States Steel could do it, why shouldn't they?

Mr. SCHOENHAUT. No, sir.

Senator SPARKMAN. Mr. Chairman, I am going to have to leave. I have an 11 o'clock appointment. I wish very much I could stay to hear the testimony of the Defense Department, but I will read the transcript in the morning, and I do plan to be here again tomorrow.

Senator PROXMIRE. Are the aluminum contracts military contracts; and, if so, for what program? Do you have the information on that?

Mr. SCHOENHAUT. I believe they are primarily military contracts or subcontracts.

Senator PROXMIRE. Do you know what program they are for?

Mr. SCHOENHAUT. No, sir.

Senator PROXMIRE. What service branch are they for, Army, Navy, Air Force?

Mr. VAN CLEVE. We don't know, Senator, but its probably predominantly Air Force.

Senator PROXMIRE. Well, if you could supply us—for the record—whatever information you have we can get some detail on this and we'd be very interested in having it.

Mr. VAN CLEVE. We'd be glad to.

Senator PROXMIRE. Could you provide information as to the size of the contract, what service and project it's for, and the companies involved?

Mr. VAN CLEVE. Yes, sir. (See exhibit 1 on p. 100.)

Senator PROXMIRE. Well, thank you very much, Mr. Schoenhaut and gentlemen. We will have additional questions for the record, including a history of the Cost Accounting Standards Board's difficulties with United States Steel and a list of all violations of all Cost Accounting Standards as known by the Board. We'd like that history. (See exhibit 2 on p. 111.)

The next witness this morning is John Bennett, Acting Assistant Secretary of Defense, Installations and Logistics.

Dr. Bennett, we are pleased you could attend today. I know it caused some dislocation of your schedule. We will proceed under the same ground rules. Your statement is accepted for the record and you will have 10 minutes or so to summarize its main points. You may wish to cover some of the points in the *United States Steel* case which Mr. Schoenhaut and I have just discussed and you might want to identify the gentleman who is with you.

STATEMENT OF JOHN BENNETT, ACTING ASSISTANT SECRETARY OF DEFENSE, INSTALLATIONS AND LOGISTICS, ACCOMPANIED BY DALE R. BABIONE, DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR PROCUREMENT

Dr. BENNETT. Mr. Chairman, I have brought with me today Mr. Dale Babione, who is the Deputy Assistant Secretary of Defense for Procurement. He has the primary responsibility in this area and, with your permission and in order to be responsive as possible, I think we'd like to both try to answer your questions.

Senator PROXMIRE. Fine. It would be very helpful. We are happy to have Mr. Babione with us.

Dr. BENNETT. I don't intend to read my statement. I'd like to just highlight it as you have requested.

The Department of Defense has supported the need for Cost Accounting Standards and is providing substantial assistance to insure successful implementation. We have taken a number of actions to implement the Cost Accounting Standards and these are outlined for your information in the formal statement.

I have also outlined the Department of Defense policy prior to the Cost Accounting Standards because I think it shows the degree of flexibility that existed and the ways we were attempting to reduce the administrative burden of the cost principles. However, the system did have some significant problems in that it was difficult to negotiate contract prices based on a contractor's cost where each contractor's accounting system was unique and subject to rapid changes. I believe this is one of the reasons that Cost Accounting Standards were adopted.

When the Cost Accounting Standards became effective, the flexibility of the contractors to change accounting practices was reduced and contract administration and audit workload were increased significantly. Today approximately 275 man-years are required by DoD to administer this program. This is a rather significant workload. The rigidity of Cost Accounting Standards and its application to contractors plus the understandable caution of our contracting officers in resolving issues have served to create extremely complex administrative problems. The extent of the administrative problems are outlined for your information in the formal statement.

Additional policy guidance—we are developing together with training and experience—should alleviate many of these administrative problems and we will continue to seek improvement in our administrative practices.

There are also a number of Cost Accounting Standards application problems. One of these occurs when a supplier adamantly refuses to accept the contract containing the CAS clause. Fortunately, this happens very infrequently, but when it does and the firm is the only one which can provide a particular product or service we find ourselves in a situation that almost defies solution. It must first be recognized that we do all possible to convince a contractor that he should accept the clause and that we cannot contract unless he does. This often fails because the contractor is aware that we can request a waiver of the requirement. We are not the court of last resort. When driven to this action we do request waivers because frankly we feel we have no other course of action. We have most difficulty with foreign companies. They are usually nonreceptive to the Cost Accounting Standard provisions which to them represent regulatory provisions of a foreign government.

In addition, the lack of an exemption for firm fixed price contracts awarded on the basis of price competition is not appropriate in our opinion.

A fourth application problem has to do with the need for further clarifications, interpretations, and definitions from the Cost Accounting Standards Board.

Each of the four areas are discussed in the formal statement together with recommendations for exempting certain contractors and revising certain CAS regulations. DoD has underway additional actions to improve the Cost Accounting Standard administration.

First, we have recently established a central working group to enhance response to Cost Accounting Standards problems. The intent here is to furnish a quick reaction to field problems and to make policy people available to field personnel for consultation and assistance. This working group will be supervised by a Cost Accounting Stand-

ards steering committee consisting of the Assistant Secretary of Defense (Comptroller), the Military Department Installations and Logistics Secretaries, and the Director of the Defense Supply Agency.

Second, a Cost Accounting Standard training program at Fort Lee, Va., will continue to train contracting officers, price analysts, and auditors. Our plan is to train approximately 150 people in fiscal year 1976.

Third, in view of our significant resource investment in implementing the Cost Accounting Standards, we wish to insure that the methodology being employed is cost beneficial to the DoD. We have initiated a study to look into this area.

Mr. Chairman, in summary, we believe that DoD is fulfilling its responsibilities in the implementation and administration of Cost Accounting Standards. The problem is, basically, one of struggling with a new and complex program. We have been working and will continue to work to develop solutions for overcoming the difficulties we are experiencing.

That concludes my statement and we are available for your questions now, sir.

[Prepared statement of Dr. Bennett follows:]

STATEMENT OF DR. JOHN J. BENNETT, ACTING ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS)

Mr. Chairman and Members of the Committee: I am pleased to appear before this Committee today to discuss our experiences in the implementation of the Cost Accounting Standards (CAS) Rules and Regulations. The Department of Defense (DOD) has supported the need for Cost Accounting Standards and is providing substantial assistance to ensure successful implementation.

In these remarks I would like to address five major areas pertinent to these hearings. These are:

1. DOD Actions to Implement CAS.
2. DOD Policy Prior to CAS.
3. CAS Administrative Problems.
4. CAS Application Problems.
5. Actions to Improve CAS Administration.

DOD ACTIONS TO IMPLEMENT CAS

Since the inception of CAS we have been aware that the new standards and regulations would require a special start-up effort to assure proper implementation and administration, and I would like to enumerate some of the actions we have taken.

To assume adequate coordination, the CAS Board Staff has been provided full access to all our personnel to assist in the development of new standards. We have utilized the Armed Services Procurement Regulation (ASPR) Committee and other top policy personnel on a priority basis to respond to proposed CAS promulgations. In the Defense Contract Audit Agency (DCAA) a CAS Branch was established to provide guidance to field audit activities and to assist the CAS Board staff in its various studies. Special management emphasis has been established to implement each standard in DOD contract administrative organizations. Together with the CAS Board staff we prepared and conducted a series of CAS training seminars for Government personnel all across the nation. In addition, other special training seminars have been conducted by the Defense Contract Audit Agency, The Defense Contract Administration Services, (DCAS), and the Air Force. Finally, a two-week training course was developed and is currently in operation at the Army Logistics Management Center, Ft. Lee, Virginia, to provide intensive CAS training to DOD personnel.

We have also recognized the need for additional personnel to administer the CAS program. Since 1973 many additional personnel have been authorized for DCAA and DCAS who have the bulk of the administrative work load. Field ac-

tivities have estimated that in Fiscal Year 1975 more than 275 man-years have been devoted to the administration of CAS.

In short, Mr. Chairman, the DOD has been diligent in its efforts to get CAS off to a good start.

DOD POLICY PRIOR TO CAS

At this point I would like to discuss the procurement environment that existed prior to CAS. I believe this will help in understanding the effect of the change that took place when CAS came on the scene.

Prior to CAS, DOD addressed cost allocation through its ASPR cost principles Contractors were required to follow "Generally Accepted Accounting Practices" as promulgated by the American Institute of Certified Public Accountants (AICPA) and other recognized authorities which have, for many years, formed the basis for accounting in the United States. Other ASPR guidance dealt with direct and indirect costs and some cost principles contained specific provisions on cost allocation. Examples are Independent Research & Development (IR&D), Bid and Proposal (B&P) compensation for personal services, and depreciation.

Cost principles permitted flexibility in accounting practices, and voluntary changes in contractors' practices could be accommodated with a minimum of administrative effort. Resultant contract cost increases and decreases were reviewed by auditors and contracting officers and judgments made as to the overall impact. Usually, the changes were phased in with no requirement to amend existing contracts, and the degree of formal review and documentation was minimized.

Thus, we did not lack for rules on cost allocation, but we had nowhere near the detail or number of rules that are evolving under the Cost Accounting Standards.

New ASPR rules were only applied to new contracts beginning at some future period to minimize administrative work load. We have found that, by delaying the effectivity date, usually to coincide with the start of a future fiscal year of the individual contractors, both contractors and DOD procurement personnel have had time to assess the effect of the new rule and plan mutually acceptable adjustments to the contractor's accounting practices so that the change could be smoothly integrated. Since the change only affected new contracts, the impact was gradual as old contracts phased out and new contracts took their place. Finally, temporary deviations were granted by the DOD to deal with unusual problems.

The point I would make is that there was a high degree of flexibility that existed prior to CAS. In addition, our procedures allowed us to minimize the administrative effort required of contractor and Government personnel in dealing with the effect of accounting system changes. However, the system did have some significant problems in that it was difficult to negotiate contract prices based on a contractor's cost where each contractor's accounting system was unique and subject to rapid changes.

CAS ADMINISTRATIVE PROBLEMS

When CAS became effective the flexibility of contractors to change accounting practices was reduced. A much more formal procedure is required when any changes are made.

A contractor subject to CAS must now submit a very detailed disclosure statement describing the accounting practices he uses. Once this is placed on record, he must follow those detailed practices in full or be in violation of the CAS regulations. If he desires to change a practice, it must be submitted to the administrative contracting officer for review together with a detailed analysis of the cost impact on a contract-by-contract basis. Contractors have told us that the effort involved in this procedure, when a large number of contracts are involved, is so onerous that they are reluctant to make changes voluntarily, even though the changes may be desirable improvements that are supported by the auditor and contracting officer. Our experience thus far indicates that preparation of contract impact data by the contractor, review by the auditor and contracting officer and subsequent negotiation of contract adjustments can truly be an undertaking of major proportions. We are also concerned that even though the impact may not be significant, a formal review and documentation is required.

Under present regulations, any change in accounting practices, whether voluntary or based on a new standard, requires the contractor to analyze the impact on all CAS covered contracts and subcontracts. Some of these may be fixed-price, some incentive and some cost type. Each is affected in a different way by a change

in cost allocation. For a major contractor with several hundred contracts, this review can become an enormous undertaking. Subsequent modification of all these contracts involving many fund citations of different military departments and even other agencies further exacerbates the problem. Moreover, the lack of precedents and experience to guide contracting officers and contractors in the settlement of CAS issues causes delays and additional work as the participants seek solutions to new problems.

The rigidity of CAS in its application to contractors plus the understandable caution of our contracting officers in resolving issues have served to create extremely complex administrative problems. Additional policy guidance and training which we are developing, together with experience, should alleviate many of these, but we shall continue to seek improvement in our administrative practices.

CAS APPLICATION PROBLEMS

I would like to turn now to the problem we face when a supplier adamantly refuses to accept a contract containing the CAS clause. Fortunately, this happens very infrequently; but when it does, and the firm is the only one which can provide a particular product or service, we find ourselves in a situation that almost defies solution. It must first be recognized that we do all possible to convince a contractor that he should accept the clause and that we cannot contract unless he does. This often fails because the contractor is aware that we can request a waiver of the CAS requirement. When driven to this action we request waivers because, frankly, we have no other course of action. Some have suggested that we immediately invoke the provisions of the Defense Production Act which would require a contractor to perform. However, the DOD has serious doubt that this is a workable solution. The Cost Accounting Standards Law prevents us from contracting without inclusion of the CAS clause or obtaining a waiver, and without a contract there is no basis for the Government to take delivery and pay for the needed supplies even if ordered under the Defense Production Act. It is our understanding that the Director, Office of Preparedness, General Services Administration, has stated in his letter of 17 July 1975 that refusal to comply with the Cost Accounting Standards cannot be considered a refusal to produce under a priority order.

We have also had difficulty with foreign companies. They are usually nonreceptive to the CAS provisions which, to them, represent regulatory provisions of a foreign Government. From a practical standpoint, we have no leverage to require acceptance of CAS by foreign contractors with which we are required to contract.

In addition, the lack of an exemption for firm fixed-price contracts awarded on the basis of price competition is not appropriate in our opinion. There are situations where formal advertising cannot be used, but award is based on price competition and cost data is not needed. Such contracts should be exempt on the same basis as advertised awards. This would also serve to bring the administration of CAS closer to the procedures of Public Law 87–653.

As CAS evolves, we believe it should have primary application to large defense contractors. It is essential that such contractors be the main concern since most Defense dollars are spent with such companies. On the other hand, other companies, some very large, whose primary business is with non-Defense customers are oriented to different types of accounting methods, because their production methods are different from those in Defense industry, or their customers do not require the type of cost data desired by Government procuring activities. These companies often resist CAS and refuse to change their accounting systems to conform to the Standards. Even when they accept CAS, they often do not change their accounting practices but simply keep separate records for the few CAS contracts they have. In some cases they have indicated an intention to withdraw from Defense business. We are concerned that this not lead to reduced competition or less qualified suppliers.

ACTIONS TO IMPROVE CAS ADMINISTRATION

The DOD is currently taking a number of actions which we believe will contribute to improving CAS implementation.

1. Establishment of a central group to enhance response to CAS problems

This operation has just been established to focus high level attention on CAS problems. There is a working group made up of representatives from top level

policy offices of the Military Services, Defense Contract Administration Services, and Defense Contract Audit Agency. Under the chairmanship of an Office of the Assistant Secretary of Defense (Installations & Logistics) representative, this group will actively seek out CAS administration problems and provide interim guidance and assistance to field activities. The intent here is to furnish a quick reaction to field problems and to make policy people available to field personnel for consultation and assistance. The working group will set up a reporting and tracking system, will publish instructional material, and will initiate proposals for changes in ASPR. The group will also be responsible for evaluation of field practices and expediting the processing of CAS actions, ASPR policy, and CAS regulations and will establish a hot-line service for field organizations. All this will be under the overall guidance of a CAS Steering Committee consisting of the Assistant Secretary of Defense (Comptroller), the Military Department Installations and Logistics Secretaries, and the Director, Defense Supply Agency. I will chair this Committee.

2. Training program

Our CAS training program at Fort Lee will continue to train contracting officers, price analysts, and auditors. Our plan is to train approximately 150 people in FY 1976. We see this as an on-going program that will be necessary as long as new standards continue to be published.

3. Cost effectiveness study

In view of our significant resource investment in implementing the Cost Accounting Standards, we wish to ensure that the methodology being employed is cost beneficial to the DOD. Also, some contractors have indicated that the current approach in applying CAS standards may be more costly than the benefits derived. In an effort to get a better understanding of the cost effectiveness problem, we have recently established a study project which has been assigned to the Army Logistics Management Center at Fort Lee, Virginia. We expect this work to be completed within the next few months and are hopeful that it will produce information and recommendations for revising our administrative practices, or even the CAS Board rules and regulations.

4. Exemptions and other changes

There are four areas where exemptions and other changes in CAS implementation should be considered. On 12 March 1975, we wrote the CAS Board to request their consideration of establishing an exemption for any contractor's profit center with less than 5 per cent defense work. In our view, it is unrealistic to expect a contractor to agree to follow CAS regulations which will increase his administrative cost, require changes in his accounting practices, and eliminate his flexibility to make accounting system changes to accommodate a very minor part of his total sales. His reaction is likely to be an uneconomic decision to segregate defense work or discontinue taking defense contracts. The CAS Board is currently reviewing this proposal.

In addition to the 5 per cent exemption, we are also preparing requests to the Board to exempt foreign prime and subcontractors, and firm fixed-price contracts awarded on the basis of price competition.

The fourth area is the need for further clarifications, interpretations, and definitions from the CAS Board. For example, it is suggested that the Board define the term "cost accounting practices", interpret the meaning of "increased costs", and indicate the latitude allowed in the application of offsets in contract price adjustments. We expect to work closely with the Board in developing these definitions and interpretations.

In summary, we believe DOD is fulfilling its responsibilities in the implementation and administration of Cost Accounting Standards. The problem is basically one of struggling with a new and complex program. We have been working and will continue to work to develop solutions for overcoming the difficulties we are experiencing.

This completes my statement, and I will be glad to answer any questions you may have at this time.

Senator PROXMIRE. Well, thank you, Dr. Bennett. Mr. Babione, we are very happy to have both of you gentlemen.

As you might conjecture, Dr. Bennett, I have the feeling from having heard the previous witness and having looked at the record

that—having the DoD enforce the Cost Accounting Standards Board—is about as close to having the fox guard the chicken as I have ever seen. It seems to me that old fox has a mouth now just dripping with chicken feathers. The DoD has a record here of great sympathy for the defense contractor, a willingness it seems to go along requesting waivers when the case was not justifiable, a failure to give the Cost Accounting Standards Board the information they need and the documentation they need and the facts they need. I just wonder if you can help us explain how the Defense Department really views its role with respect to the Cost Accounting Standards Board.

You have given us some detail on it. I'd like you to express the attitude the DoD has now. This is a law that has been passed. It's been in effect for 5 years. It's the law of the land. How do you justify the kind of record which has been portrayed in the preceding hour?

Dr. BENNETT. Well, I think I can understand how you perceive that we're soft on implementation and administration of Cost Accounting Standards, but I don't think that's completely so. I think the fact that we have these numbers of violations that have been detected is a real indicator that we are on the firing line trying to administer and trying to implement this system. That's one aspect.

Senator PROXMIRE. You don't have any information though given to the Cost Accounting Standards Board about what you're doing about those 423 violations of promulgated standards and 92 failures to follow disclosed accounting practices.

Dr. BENNETT. We have been reporting on an annual basis. We are now, through the new CAS steering committee and working group, initiating procedures to report on a monthly basis. We recognize that the reporting of this has not been as good as it could be and we are taking steps to correct the problem. I think it's incorrect, however, to assume that because the violations are not reported to the Cost Accounting Standards Board that they are not adequately settled in accordance with our responsibility and in accordance with the law. I don't think that follows, sir.

Senator PROXMIRE. Well, one great difficulty here is that there's an understandable and to some extent an appropriate concern by the DoD for defense contractors, for their well-being and health. That's good. We need a profitable and prosperous defense industry. But we also need to carry out the law rigorously and to see that the costs in a contract are honestly and fully reported and reported with the uniformity that makes that report meaningful and understandable. Here the record is very bad as far as the Defense Department is concerned.

Dr. BENNETT. I don't think it is very bad.

Senator PROXMIRE. Well, there are 423 violations. Now you have failed to report what the disposition has been either to the Cost Accounting Standards Board or anybody else as far as I know. Have you made a report to the Armed Services Committee or the Appropriations Committee or any other agency outside of the Defense Department?

Dr. BENNETT. No; but you have asked that the GAO look into this. The GAO is presently conducting, has conducted a study for the Cost Accounting Standards Board and has prepared preliminary draft material for a report. I think when it comes to your attention you will

find that they say that our administrative contracting officers and our auditors are carrying out their full responsibilities very conscientiously and to the letter of the law.

Now this doesn't mean that there are not some poor judgments that occur. It doesn't mean that we are not going to make mistakes. It doesn't mean that we don't have problems.

Senator PROXMIRE. Here we have a law where you have hundreds of violations and the only penalty for the violation is that they have to reimburse for the excessive payment that's been made with interest of 7 percent. Now that seems to me to be wholly inadequate. It seems to me it provides an incentive for violation. No. 1, you might not be caught. If you are, then you're ahead maybe millions of dollars. No. 2, if you are caught, great, you only have to pay an interest that's below market.

Dr. BENNETT. I think you're making an assumption that a violation has a cost attached to it. Many of them do not have costs attached to them.

Senator PROXMIRE. I'm sure if you have 423 violations some of them do have costs attached to them.

Dr. BENNETT. I think some do, yes, but most of the violations are inadvertent violations.

Senator PROXMIRE. I think that's the case. I don't want to give the impression that every defense contractor is looking for a way to evade the law, but there is a clear opportunity and a lack of effective penalty and provision to see that the law is abided by and it seems to me that the taxpayer probably is losing millions of dollars here.

Dr. BENNETT. I think that that's a legitimate question to answer and I would think that you would want the Cost Accounting Standards Board to tell you what the cost-benefits of implementing this law are and what the losses are and so forth. We have attempted to do this. I think from my understanding, the Cost Accounting Standards Board has also attempted to do this, but neither one of us has been able to get adequate information.

Senator PROXMIRE. One of the difficulties is I get the impression from reading your statement, Dr. Bennett, that you feel as many contractors undoubtedly feel, that compliance is very costly. However, I got the impression from listening to the previous expert witness that compliance is usually not costly, that compliance in the case of United States Steel, for example, is something they can do without any big revision of their accounting system. It can be done—at low cost—if they will sit down and talk with the Cost Accounting Standards Board and work something out.

On the basis of the testimony we had before—and as I said, its never been denied—we lose about $2 billion a year by not having uniform accounting standards. Now that may be wrong. It may be a billion or a billion and a half, but it's a whale of a lot of money and the notion that the costs are greater than that on the basis of any record I have seen seems to be a very weak argument.

Dr. BENNETT. Our concern is for the 275 man-years that we spend. That's a pretty significant cost to us.

Senator PROXMIRE. How much?

Dr. BENNETT. 275 man-years. We don't know and neither does the Cost Accounting Standards Board know what the cost is to a con-

tractor to implement this and the scene is rapidly changing. First there were two Cost Accounting Standards, then there were four and now there are nine. Soon there will be 11. The costs are going up. Cost Accounting Standard 409 will create additional administrative work load for the contractors.

Now the contractors tell us that implementation of these Standards is going to entail a very significant cost. We ought to know these costs. The Cost Accounting Standards Board ought to know this, but we don't know it, sir.

Senator PROXMIRE. On the basis of Admiral Rickover's $2 billion estimate—and that was 5 years ago and things are much more costly now with inflation and everything—the 275 man-years I estimated at $20,000 a man-year would be $5.5 million. The ratio therefore would be 400-to-1 benefit-cost ratio. I'd sure like to make that kind of investment. You get your money back each day; 400 to 1 means you can get better than 100 percent return every single day of the year. Very few investments you can make are comparable to that.

Now maybe that's wrong. Maybe it's not a $2 billion saving. Maybe it's a billion or a half a billion. Whatever it is, you have to go a long way down the scale before you fail to get a very, very favorable benefit-cost ratio.

Dr. BENNETT. I'd be happy to share that with you if we could split it. It certainly sounds like a good factor or a good return. I don't think, however, that the DoD is thwarting implementation of the Cost Accounting Standards.

Senator PROXMIRE. You see, what concerns me, Dr. Bennett, is that frankly the father of this, like the father of the nuclear submarine, is the same person. It's Admiral Rickover. Admiral Rickover believes, as you know, in a strong defense industry. He believes in strong defense. He is not a critic of the Defense Department. He doesn't believe in a weak defense. He called for uniform cost accounting standards and he made the estimate of the $2 billion a year loss.

On the basis of that, I just wish there were more people in the Defense Department that had the same kind of zeal for getting your money's worth that Admiral Rickover has demonstrated. I think we'd have a far better defense operation. I get the picture here that there's a real softness with respect to vigorous enforcement.

If there are real costs, aren't they break-in costs that will drop away when uniform Standards are in effect across the board?

Dr. BENNETT. I think there is a considerable amount of start-up costs, but I believe that there will always be certain costs to the Government in terms of auditing, in terms of contracting, in terms of any accounting change, because we must document and audit each accounting change and then that accounting change must be compared for a cost impact on every contract that's outstanding. That's a considerable workload to do that. A similar type workload will exist with the contractor; but you're right, there are a lot of start-up costs and once CAS becomes a standard operating procedure, normal practice, a good portion of those costs will drop off.

Senator PROXMIRE. Now let me go back to a statement that you made indicating how very difficult it is for the Defense Department to get

compliance. This is one of the most troublesome elements of your presentation.

You say in your prepared statement,

> It must first be recognized that we do all possible to convince a contractor that he should accept the clause—the Cost Accounting Standards clause and we cannot contract unless he does. This often fails because the contractor is aware that we can request a waiver of the CAS requirement. When driven to this action, we request waivers because, frankly, we have no other course of action. Some have suggested that we immediately invoke the provisions of the Defense Production Act which would require a contractor to perform. However, the DOD has serious doubt that this is a workable solution.

You go on to say why.

Now I discussed this with my staff and when I read your statement I was rather sympathetic with your view. I thought maybe the Defense Department was in a dilemma, maybe the contractors had them over a barrel, maybe if a contactor refused to abide by the Cost Accounting Standards there's nothing DoD can do except request a waiver. But I am persuaded by my staff's research that this isn't the case. They tell me under the Defense Production Act you can require performance and, indeed, if you can't we'd better change the law because if we ever get a situation in this country where a defense contractor can just defy the law and blackmail the Federal Government into going along with that failure to comply with the law, then it seems to me that we are in a really desperate position.

The research shows that we can mandate compliance by a contractor through using the Defense Production Act and simply requiring it to perform; that has been done in wartime. The President still has that emergency power. The Defense Production Act provides that emergency power and we can require performance by a contractor if we need it such as we needed steel for submarines in the *United States Steel* case.

Dr. BENNETT. I wish I was as certain as your staff is that that can be done. Our discussions with General Bray—and we have had a series of letters from him and I think you have copies of these letters——

Senator PROXMIRE. I do have, and the copy of the letter I have says exactly the opposite of what you say in your statement.

Dr. BENNETT. I don't think so.

Senator PROXMIRE. I'm going to get the letter and read it to you and it's an absolute contradiction.

Dr. BENNETT. Well, we have had some additional telephone conversations with him and his interpretation is that you can direct delivery of items but you can't direct that contractors comply with the Cost Accounting Standards.

Senator PROXMIRE. I'll read what you say in your statement and then I'll read what General Bray said in his letter to me. You say:

> The Cost Accounting Standards Law prevents us from contracting without inclusion of the CAS clause or obtaining a waiver, and without a contract there is no basis for the government to take delivery and pay for the needed supplies even if ordered under the Defense Production Act. It is our understanding that the Director, Office of Preparedness, General Services Administration, has stated in his letter of 17 July 1975 that refusal to comply with the Cost Accounting Standards cannot be considered a refusal to produce under a priority order.

Now that letter of July 17 says: "Dear Mr. Chairman"—it's addressed to me and it says as follows:

I have examined the DPS Regulation 1 and the Defense Production Act to determine whether the Regulation provides a basis for a defense contractor to refuse a rated order if the order contains provisions required by law that the contractor does not choose to accept. In my view, the DPS's regulation does not provide a basis for such a refusal.

(For complete letter, see exhibit 3 at p. 117.)

Mr. BABIONE. Mr. Chairman, the interpretation there is that refusal of the order means delivery of the item. Sure, you can require the contractor to deliver the item, but the terms and conditions that go with it are a separate matter which he discusses in the sentence on page 2. He's making a distinction between the requirement to have a contractor deliver a product or service and also requiring the contractor to accept terms and conditions that are unique to the DoD. What he's saying is that you can force United States Steel to give you the steel, but you can't force them to take the CAS clause. The dilemma with that is there's no way for the DoD to accept delivery without a contract. There's no way for us to pay on that contract without including the clause because the clause is required by law.

So, therefore, how do we accept delivery, even though the contractor will deliver without a contract if necessary, and still comply with the law?

Senator PROXMIRE. Well, we have had some instances in the past. I can recall a confrontation between the Federal Government and Montgomery Ward in 1943 when the Government required compliance to the extent of picking up the chairman of the board of Montgomery Ward and carrying him right out of the building in order to require them to act.

Now you say that particular terms and conditions cannot be enforced and without a contract you don't have a basis for that. I understand that. What I'm saying, however, is that you can require performance and you can require that in this case the steel be delivered to Electric Boat by United States Steel.

Mr. BABIONE. We have to go further than that, Mr. Chairman. We have to provide a basis for the Government to accept it and we can't accept it without a contract and we can't have a contract without the clause.

Senator PROXMIRE. Then are you saying we have a situation in this country where industry can simply defy the Federal Government and can frustrate our defense effort. Say you have a sole source. We have many situations like this and the sole source says, "We are just not going to give you the steel. We are not going to give you the chemicals you need for a particular missile." Does that mean the Government is helpless? We can't defend ourselves?

Mr. BABIONE. What we're saying is our counsel has reviewed this in some depth and in their best judgment, General Bray is saying there is a distinction between requiring a contractor to perform and requiring him to accept certain terms and conditions in a contract.

Now it's feasible or maybe conceivable that General Bray could redefine the regulations under the act to include CAS terms and conditions, but all we're saying here is, the letter does not say that. The letter says that he is not including CAS terms and conditions as a part of his interpretation of what is required by the act.

Senator PROXMIRE. Well, at any rate, the letter is very clear in that sentence that I read that the DoD can require performance, and you

say that in order to make that effective you have to have additional authority?

Mr. BABIONE. Yes, sir.

Senator PROXMIRE. All right. That's a problem for the Congress then.

Dr. BENNETT. We were prepared to use the Defense Production Act when United States Steel contested, but there are differences of opinion and interpretation and our legal interpretation is that unless General Bray was prepared to make the interpretation that it did include the contractual provisions, we could not use the Defense Production Act. But we were going to take that step. We were prepared to take that step.

Senator PROXMIRE. Do you have the authority under Public Law 85–804?

Mr. BABIONE. Yes; in certain respects. To what part are you talking about?

Senator PROXMIRE. That's Public Law 85–804 and I quote:

> The President may authorize any department or agency of the Government which exercises functions in connection with the national defense, acting in accordance with regulations prescribed by the President for the protection of the Government, to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts.

Mr. BABIONE. My only answer to that is that our legal people——

Senator PROXMIRE. "Without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts."

Mr. BABIONE. Yes, sir. Our legal people have looked into this and as far as they can determine at this time—they are still researching it—they know of no way under the current law or any of the laws—and I assume that includes Public Law 85–804.

Senator PROXMIRE. This is a gray area. The only way to get confirmation of the law is to get a test case. Have you tried that route?

Dr. BENNETT. We were about to try it with United States Steel. That was our route to go. We have not tried that route.

Senator PROXMIRE. It's hard to tell until you do, or we have the option, as I said, of having Congress pass a new law. Anyway, we shouldn't throw in the towel until we've tried it.

Dr. BENNETT. No. I would concur with that.

Senator PROXMIRE. United States Steel says it's delivering needed steel without a contract and has been for some time. Is it being paid or are we getting steel on the cuff?

Mr. BABIONE. I can't answer that. I don't know specifically what particular subcontract they're talking about or what particular delivery time frame they're talking about, but that's been United States Steel's position all along. "We will deliver. We won't hold you up, but we won't take the clause." And our position is how can we accept delivery if we don't have a contract? That's not legal, and to have a contract we have to include the clause.

Senator PROXMIRE. This isn't a theory. This is a fact. They have been doing this now for some time. Apparently they have been paid for it and they have been proceeding without a contract.

Mr. BABIONE. Well, there are a number of subcontracts and that goes back to your original point, some of which require the CAS clause,

some of which may not because they were exempt due to adequate price competition. This is a CAS exemption for subcontracts, if the bids are for identical items. I think that was sort of a general statement they made to assure the committee and the public that they were not holding up any vitally needed supplies.

Senator PROXMIRE. Don't you know what you're getting from United States Steel on which contract? Don't you have that information? Doesn't DoD know?

Dr. BENNETT. The U.S. Navy knows and we have asked the Navy to look into this particular problem. The Navy is contract administrator for the Trident submarine and Electric Boat.

Senator PROXMIRE. In the DoD letter to the Cost Accounting Standards Board I understand it was said that steel was being held up.

Mr. BABIONE. I think that's also true. You see, the problem with this is——

Senator PROXMIRE. Are you sure that's true? Because that's been denied by United States Steel.

Mr. BABIONE. Let me put it this way. We are basing our statement on information supplied by the Navy which we have accepted at face value.

Senator PROXMIRE. Do you have that in writing?

Mr. BABIONE. From the Navy? Yes, sir.

Senator PROXMIRE. Will you furnish that information to the committee?

Mr. BABIONE. The information that was in the request for the waiver was prepared by the Navy.

Senator PROXMIRE. Can you give us the information from the Navy?

Mr. BABIONE. Yes, sir.

Senator PROXMIRE. We want the letter signed.

Mr. BABIONE. Whatever documentation exists we will furnish it. (See exhibit 4 at p. 123.)

Senator PROXMIRE. Is there any reason in particular, Dr. Bennett, why your request for a waiver cited only one case when the company says it has accepted several contracts with this clause?

Mr. BABIONE. We have been working with the CAS Board but the CAS Board determines what information is to be supplied. We would not argue that their instructions appear to include both prime contracts and subcontracts, but it's my understanding that we have told the CAS Board our data bank does not include subcontract award information. Thus our information on subcontracts is quite limited. We must depend on the vendor involved to supply this information. We do supply information on prime contracts where that information is readily available.

Our understanding is that this has been an acceptable practice. Now that doesn't mean that what we did was not incomplete. We should have better information on CAS covered subcontracts and should provide it to the Board. We believe we can and should do a better job in the future.

Senator PROXMIRE. I understand United States Steel says there are several situations in which they have accepted the Cost Accounting Standards clause.

Mr. BABIONE. We would have to ask the Navy for that information, Mr. Chairman, and provide it for the record, (see exhibit 5 at p. 128).

Senator PROXMIRE. The situations go back, I understand, to 1972 or 1973. It goes back several years. Doesn't neglecting to mention the additional acceptances put the Cost Accounting Standards Board in a situation where they are trying to make a decision without the information they need? If CAS knew that there had been acceptances before it would be much less likely to grant the waiver. By DoD concealing this or by not revealing it, it seems to me the Board is misinformed and therefore it is much more likely to go along on the waiver to the detriment of the taxpayer and probably to the detriment of the whole system. Once you give a waiver of this kind to a company as visible as United States Steel in this important a case, you can kiss the Cost Accounting Standards goodby.

Mr. BABIONE. That's certainly no attempt on the part of DoD to conceal anything, Mr. Chairman. The file did contain, as was indicated, at least one case where the contractor has previously accepted the CAS clause and that usually is the basis under which the CAS Board reacts, even if there's only been one case. The number of cases only changes the degree. There was no attempt to indicate or mislead the Board there had not been any. It might have been a poor job in accumulating the facts and presenting the case.

Senator PROXMIRE. Mr. Schoenhaut has just told us about 19 subcontracts for special steel required of United States Steel by General Dynamics. The value is about $18 million. These subcontracts are conditional upon waiver of Cost Accounting Standards.

Has the DoD requested a waiver on these?

Mr. BABIONE. No. The DoD has requested no waiver on any of these subcontracts that have been discussed.

Senator PROXMIRE. Why not?

Mr. BABIONE. We asked the Navy to check them out. I don't believe that all 19 cases were ones that had conditional terms on them. Some of them were subcontracts through Newport News. Some of them were subcontracts with Electric Boat. Some of them had price competition. Some of them did not. And we have to sort them all out.

Senator PROXMIRE. Do you know at present whether a waiver will be requested or a waiver request will be forwarded in view of the United States Steel agreement?

Mr. BABIONE. We certainly do not intend to ask for any waiver unless it's determined to be absolutely necessary and appropriate under the circumstances.

Senator PROXMIRE. In view of the fact we have this agreement now in the *Electric Boat* case——

Mr. BABIONE. There shouldn't be any.

Senator PROXMIRE. I don't see any basis for a new request. From what they have said, as far as their accounting system is concerned, they can comply.

Mr. BABIONE. There shouldn't be.

Senator PROXMIRE. Now, in the case of United States Steel, DoD recommended that the Cost Accounting Standards Board waive the Standards. The Board, however, denied the waiver request and subsequently obtained United States Steel's agreement to comply.

United States Steel now admits that its present accounting system is compatible with Cost Accounting Standards. Now, this raises in my mind the question again of the chicken and the fox and the henhouse,

as to how hard the DoD really tried to implement and enforce the Cost Accounting Standards requirements.

Historically, DoD support of the Cost Accounting Standards has ranged from lukewarm to outright opposition.

Dr. BENNETT. I think first off we have to recognize there have only been four waivers requested in the last year. I think the other aspect of it is that in the case of contractors who refused to provide for the Cost Accounting Standards, it's not a question that they can't comply with it. It's a question that they don't agree with the need, and there isn't anything that the DoD, other than through persuasion, can do to convince them that that need exists and that they should comply.

Senator PROXMIRE. All right. Let me proceed along that line. You say that there's not much the Defense Department can do if they have that attitude. What efforts in fact has the Defense Department made to obtain United States Steel's compliance? Which senior Navy and Defense officials by name took time to intervene directly and personally with United States Steel in this case? What was the name and position of the most senior United States Steel executive contacted? Can you provide that for the record and provide all correspondence or exchange between the Defense Department and United States Steel in attempting to obtain compliance?

Mr. BABIONE. Yes, sir.

Senator PROXMIRE. Can you give us orally now what this amounted to?

Mr. BABIONE. The Assistant Secretary of the Navy, Mr. Bowers, was intimately involved and intimately aware of the situation, and he was the person who forwarded the request for waiver to Dr. Bennett's office.

Dr. BENNETT. And at the lower levels——

Senator PROXMIRE. Wait a minute. You say he was intimately involved and concerned and forwarded the request to Dr. Bennett's office. What I'm talking about is what effort was really made by requesting United States Steel to comply and giving them the strong argument that they should comply?

Mr. BABIONE. We'll have to obtain that from the Navy and furnish it for the record. (See exhibit 6 at p. 129.)

Senator PROXMIRE. You don't have any evidence that was done?

Dr. BENNETT. We have some evidence. Officials under Admiral Michaelis, the Navy Materiel Command, were in contact and did actually talk beyond the working level with United States Steel.

Senator PROXMIRE. Dr. Bennett, it seems to me in view of the seriousness of this—with the steel absolutely essential for 14 vital submarines—that Secretary of Defense Schlesinger should get the head of United States Steel on the phone and say, "We mean business on this. This is very vital to the defense of the United States," rather than have somebody in the Navy maybe talk to somebody in the Defense Department. There seems to be no real effort to secure compliance.

Dr. BENNETT. We believe that that should occur and we believe that it's a Navy responsibility to do that, and we think that perhaps it hasn't been at the highest level but that this kind of dialog with United States Steel has gone on.

Senator PROXMIRE. Why hasn't it been at the highest level? Does Secretary Schlesinger know about this? Did he know about it?

Dr. BENNETT. Secretary Schlesinger has not been involved with this, but Deputy Secretary Clements has been involved.

Senator PROXMIRE. Why not?

Dr. BENNETT. Because of the division of the workload between Secretary Schlesinger and Secretary Clements.

Senator PROXMIRE. What has Clements done?

Dr. BENNETT. He's monitored this through discussions that I have had with him. He knew that I was coming over. He knew what I would be saying.

Senator PROXMIRE. Has he talked to anybody at United States Steel?

Dr. BENNETT. He didn't have to talk to anybody at United States Steel because we did talk to people at United States Steel.

Senator PROXMIRE. There was a long period and they were adamant, and it looked like you would get no steel without violating the law, and if Deputy Secretary Clements is the top Defense Department official in this regard, it seems to me at the very least he should have called United States Steel and said, "Let's get with it."

Dr. BENNETT. We weren't aware of this particular problem with United States Steel until it was brought to our attention. The Navy attempted to solve the problem with United States Steel as the responsible agent.

Senator PROXMIRE. Dr. Bennett, you're the chief honcho in the cost accounting in the Defense Department?

Dr. BENNETT. That's right.

Senator PROXMIRE. It seems to me you certainly should have been kept informed of something as important as this.

Dr. BENNETT. We have administrative problems here, Mr. Chairman, and this is one of the basic reasons we have established this steering committee now and the working group so that we can have closer dialogue and closer contact, closer monitorship of what's going on in this area.

Senator PROXMIRE. Why did you have that request for a waiver from United States Steel before you for a year? We had testimony this morning that you had the request from May of 1974 until mid-July of 1975 before it was forwarded on to the Cost Accounting Standards Board so that they could act on it one way or the other.

Dr. BENNETT. We had the request for just several days in the Office of the Secretary of Defense. I have no knowledge of why the Navy had it for so long. I think the reason is that they were attempting to work the problem out with Electric Boat and with United States Steel.

Senator PROXMIRE. I can't understand why that would take an entire year. It seems to me it would take a part of a day. United States Steel's position was emphatic and clear on this. They said, "No; we're not going to comply." They never took the opportunity to sit down with and talk with the Cost Accounting Standards Board people.

Dr. BENNETT. If you'd like, we could look into it and try to get something for the record. (See exhibit 7 at p. 130.)

Senator PROXMIRE. We'd like to get as much information on that as we can because it seems there was a lack of compliance.

Now, is it your view that the Defense Department has no role to play in assessing the validity of a corporation's request of a waiver from Cost Accounting Standards. The Defense Department should have a role in this area, should it not?

Dr. BENNETT. Yes; I think so.

Senator PROXMIRE. Do you think that was done in the case of United States Steel?

Dr. BENNETT. I don't know whether you're asking whether that should be done at the Office of the Secretary of Defense. The answer to that is that it is delegated down the line to what we call an administrative contracting officer who works directly with the contractor and with the auditor who is also usually at a plant location.

Senator PROXMIRE. Dr. Bennett, have you or any of your staff had a chance to review the August 15 letter of agreement which I read at the beginning of the hearing this morning from United States Steel Corp. to Mr. Arthur Schoenhaut with respect to compliance on the Cost Accounting Standards?

Dr. BENNETT. Yes; we have had a chance. Mr. Babione and his staff have.

Senator PROXMIRE. Have you any thoughts as to what this agreement requires of the Defense Department in terms of monitoring and assuring compliance?

Mr. BABIONE. I called Mr. Smith to be sure I didn't misunderstand his letter, and the best way I can explain it is our interpretation is that except for the four well-known exemptions in the Cost Accounting Standards law which are advertised procurement, catalog price, market price, price based on law or regulation, that if they did not qualify for, any of those, that they would comply.

Now the final decision on that, of course, would be within the Defense Department, as it has been in any other particular application, and the fact that we have asked for a waiver in the case of United States Steel shows that we didn't think the five purchase orders qualify under any of those four exemptions. Otherwise we wouldn't have asked for the waiver in the first place.

So, to answer your question, I would expect complete compliance.

Senator PROXMIRE. Has the Defense Department ever in the past refused to forward a company's request for a waiver to the Cost Accounting Standards Board or is it your practice to forward any request that was sought?

Mr. BABIONE. I have only been here since September.

Senator PROXMIRE. Well, first let's start with your experience. In your experience, has the Defense Department forwarded the request for a waiver in all cases?

Mr. BABIONE. I can't think of any. We are only talking about four that have been submitted.

Senator PROXMIRE. Well, now, you have been here since last September, less than a year. Is there somebody in the room who's been here longer who can tell us what the record has been over the past 4 years?

Mr. BABIONE. Could we provide that for the record, Mr. Chairman? (See exhibit 8 at p. 134.)

Senator PROXMIRE. All right.

Do you have any general views which you would like to express of the Board's denial of your request for the agreement with United States Steel that you haven't expressed so far?

Dr. BENNETT. No, Mr. Chairman.

Senator PROXMIRE. Now I understand that there are currently five specific orders involving United States Steel that were the subject of the Defense Department waiver request. Now that United States Steel has agreed to comply with Cost Accounting Standards, I'd like the following information regarding each of the five orders in question.

First, has United States Steel signed a contract containing the Cost Accounting Standards requirement? Do you know that?

Dr. BENNETT. We don't know this, but we would assume that the answer is "No," in these five particular cases. We will get that information and provide it for the record. (See exhibit 9, p. 134 and exhibit 23, p. 259.)

Senator PROXMIRE. When do you expect that they would sign the contract?

Mr. BABIONE. I can't answer that, Mr. Chairman.

Senator PROXMIRE. What would be a logical time? This letter is dated August 15. That was 5 days ago.

Mr. BABIONE. It should be signed in whatever the minimum lead time for production is, between the date of the award and the delivery date.

Senator PROXMIRE. When would that be?

Mr. BABIONE. I don't have the dates on which the deliveries are to be made on these particular purchase orders.

Senator PROXMIRE. Do you expect to have it in the next month or two?

Mr. BABIONE. I would expect the whole thing to be resolved within 90 days.

Senator PROXMIRE. Have you pricing data for each of these orders as required by the Truth-in-Negotiations Act?

Mr. BABIONE. My understanding is that in discussions with the Navy that United States Steel indicated it was going to provide all necessary cost data under Public Law 87–653 at the Christy Park Works for the air flask work. This is about $5.4 million of the total of $7 million and relates to purchase orders 5077 and 5235.

At the other two locations the contractor claimed that he was entitled to an exemption from Public Law 91–379 and Public Law 87–653. Obviously, the Navy did not agree since they processed the waiver.

Senator PROXMIRE. Will you provide the committee staff with a copy of the signed purchase orders in question when they are available?

Mr. BABIONE. Yes, sir.

Senator PROXMIRE. Has the Defense Department obtained United States Steel's agreement to provide certified cost and pricing data required by the Truth-in-Negotiations Act in any future procurements?

Mr. BABIONE. I didn't understand the question, Mr. Chairman.

Senator PROXMIRE. Well, we have settled the Electric Boat—these five cases. What I'm talking about now is United States Steel's attitude toward future procurements. Having discussed this situation with the Cost Accounting Standards Board and having reconciled it in this particular instance, does this have any bearing on future procure-

ments? Has United States Steel indicated that under these circumstances they will comply in the future?

Mr. BABIONE. Well, it's my understanding in the discussions that I have had with United States Steel with Mr. Smith of United States Steel they will comply in the future and that we also assume—and I made this point very clear to him—that if he's going to comply with the Cost Accounting Standards clause it also means he's going to comply with Public Law 87–653, even though the letter doesn't say that.

Senator PROXMIRE. What's that again?

Mr. BABIONE. The Truth-in-Negotiations Act is Public Law 87–653 whereas the CAS law is Public Law 91–379.

Senator PROXMIRE. So to date they haven't indicated whether they will or not?

Mr. BABIONE. Mr. Smith indicated verbally to me that they would.

Senator PROXMIRE. That he would. Very good.

I'm curious to know, Dr. Bennett, why the request of the waiver on behalf of United States Steel was forwarded to the Cost Accounting Standards Board in mid-July when the company claims it first asked for this waiver last winter. Can you give us any further information on that?

Dr. BENNETT. No, I can't, Mr. Chairman. We'll have to research it with the Navy and find out. We will furnish this to you for the record.

Senator PROXMIRE. Woud you submit for the record a copy of your request to the Cost Accounting Standards Board for a waiver of the contract clause? (See exhibit 10 at p. 136.)

Dr. BENNETT. Yes.

Senator PROXMIRE. I believe this request contains considerable information regarding prior lack of cooperation with the Defense Department by United States Steel and other companies, especially in regard to provisions of cost and pricing data under the Truth-in-Negotiations Act.

Would you explain why this information is germane to the present request for a waiver from Cost Accounting Standards?

Mr. BABIONE. No particular reason other than to give the Board the most complete picture we had as to what the situation was.

Senator PROXMIRE. Well, I think it's a good thing. I'm glad you provided it. I think it is essential.

In your written statement, Dr. Bennett, you went to some pains to point out Cost Accounting Standards are more trouble than they are worth. It's my understanding that the Defense Department has as one of their management objectives reducing the impact of these accounting Standards on the Defense contractors. Mr. Schoenhaut has testified these Standards can be accommodated by industry without working a hardship.

Is it possible that the Defense Department is too quickly accepting at face value the contractor claims that these Standards cause accounting headaches? Have you done any studies of your own on these claims? Are they available for the record?

Dr. BENNETT. Our management objective is to streamline the administrative procedures within the Defense Department to minimize the administrative costs and the delays and administrative problems

that we have. Mr. Schoenhaut did talk in terms of the new directive that we put out in March and how he expected this to improve the situation and cut the time delay down, cut the numbers of times papers go back and forth.

Senator PROXMIRE. And you agree with that?

Dr. BENNETT. Yes, sir.

Mr. BABIONE. The objective is not to do away with the Cost Accounting Standards, but to administer them in the most efficient way.

Senator PROXMIRE. You said the new directive?

Mr. BABIONE. There's a Defense procurement circular revising the armed services regulation which was put out last March. That was DPC 74–5.

Senator PROXMIRE. Will you provide that for the record? We'd like very much to have that. (See exhibit 11 at p. 142.)

Mr. BABIONE. Yes, sir.

Senator PROXMIRE. Several months ago the Defense Department requested a waiver of Cost Accounting Standards on behalf of the Mobil Oil Corp. The Board declined to grant the waiver. Subsequently, Mobil agreed to comply with the Cost Accounting Standards.

We now appear to have repeated the situation with United States Steel. In both cases there were contentions by the contractors that their accounting systems could not accommodate Cost Accounting Standards. In both cases it was determined not to be the case.

What steps did the Defense Department take before the waiver request to determine the accuracy of contractor contentions that their accounting systems could not accommodate CAS and were these efforts ineffective?

Mr. BABIONE. The Mobil case was a procurement handled by the Defense Supply Agency and there were several meetings with the Agency in an attempt to explain to the Mobil people very specifically what was required and how it could be accommodated. CAS Board representatives were included in one of these meetings. Mobil always chose to say they couldn't conform to the Cost Accounting Standards. We have interpreted that to mean they wouldn't conform to the Cost Accounting Standards; but either way, we were faced with the same problem.

Senator PROXMIRE. In both cases the Defense Department accepted the position of the contractor and passed it on. In both cases the Cost Accounting Standards Board resisted and in both cases the Cost Accounting Standards Board prevailed and found out that after all there's no real problem.

Dr. BENNETT. I think in the Mobil case you will find that the Cost Accounting Standards Board did work with the Defense Supply Agency (DSA) in trying to convince the Mobil people before the paperwork came forward that they could comply.

Senator PROXMIRE. Who did this?

Dr. BENNETT. The Cost Accounting Standards Board staff.

Mr. BABIONE. Mr. Schoenhaut's people.

Dr. BENNETT. In the Mobil case they were working with the DSA and Mobil to try to convince Mobil that they could comply.

Senator PROXMIRE. Well, this is the kind of thing that I wish the Defense Department would do more of. I notice in your Management

Objective Number 8 you have here an Action Number 10, Cost Accounting Standards [reading] "and to relieve contractors of unnecessary restraints of their accounting practices." You go on to say, "The directorate for procurement policy has for some time been seeking to have contractors relieved of the requirement to comply with Cost Accounting Standards rules and regulations when the amount of Defense work for the contractor is minimal as compared to his other business,"—would this apply to people like United States Steel and Mobil?

Mr. BABIONE. No, it would not apply to the United States Steel case, Mr. Chairman. Five percent—all we are trying to do in the administrations of the law is figure out a way of having a de minimus rule that considers the cost-benefit relationship of CAS compliance. We have suggested and the Board is now reviewing our proposal for exempting contractor's profit centers which would have less than 5 percent defense business.

Now there would also be a dollar ceiling depending on the size of the profit center. Large companies have many profit centers and each would be considered. That ceiling dollar amount could be any arbitrary number chosen. There have been several numbers discussed in the Defense Department and with the Board.

In the case of United States Steel, a 5-percent rule would not have excluded the Christy Park Works which has the $5.4 million portion or the main part of the requirement being discussed here. The Defense Department views the current $500,000 exemption rule as a very low rule under which almost no company or division is excluded. We are just looking for a more efficient way of implementing the Standards than the $500,000 rule. We are not talking about exemptions affecting more than a minor amount of defense dollars.

Senator PROXMIRE. I hope you proceed with as much information as possible. I think we have learned this morning that the Cost Accounting Standards Board has made a very good case that oftentimes compliance isn't costly and it isn't difficult. Even on contracts as small as $100,000 or $50,000 it's conceivable that it might be no harder to comply than not to comply. I think we have to have some kind of a case, some kind of a record based on actual experience, not just pick a figure out of the air and say we're going to have the exemptions for contracts smaller than that figure.

Mr. BABIONE. The Board is studying it.

Senator PROXMIRE. I hope we can get a report on that so we can follow it.

The Defense Department furthermore, in instituting its program to improve relations between the Department and private industry, made a recommendation that the authority to waive the requirements of Cost Accounting Standards be delegated from the Board to the procuring agency, including the Department of Defense. Now this is said to be necessary in order to make consideration of waivers requests more timely.

Now there are several reasons why I think this would be disastrous, especially in view of the record we have made here this morning. I understand the Board has acted very quickly on such requests. Furthermore, we have this case of United States Steel where the Navy

and the Defense Department had the request for more than a year and it was a matter of days after the Cost Accounting Standards Board got it that they acted.

Now let me ask in connection with this, does the Defense Department continue to advocate that waiver authority should be delegated by the Board to the procuring agencies?

Dr. BENNETT. No. That's not an active letter any longer but I think you should recognize——

Senator PROXMIRE. It's not an active letter any longer?

Dr. BENNETT. That's not an active request on the part of the Defense Department.

Senator PROXMIRE. You're no longer requesting it?

Dr. BENNETT. That's right. We have asked for the 5-percent waiver from the Cost Accounting Standards Board. We would like to bring to your attention the way the process is set up.

The Defense Department does not have the clout or the persuasion to convince these companies with the waiver authority sitting at the Cost Accounting Standards Board. What we are essentially doing is exhausting the waiver route so, if we have to apply the Defense Production Act or whatever, we can do that. We know informally from talking to these companies that they are not going to accept the Office of the Secretary of Defense saying, "We are not going to grant the waiver." They are going to insist that it go to the highest authority and that authority rests with the Cost Accounting Standards Board and not with the Department of Defense.

It's our feeling that the United States Steel backed down on this because of the unfavorable publicity and that's the clout that you have, sir.

Senator PROXMIRE. That unfavorable publicity couldn't have been developed if the Defense Department had handled it by themselves. If the recourse to the Cost Accounting Standards Board didn't exist, the Joint Committee would have had no opportunity to get into it, and there wouldn't have been any compliance. And, in my view, the Cost Accounting Standards Board would be dead. Once you make that kind of exception it's very hard to resist. You can imagine how firms in the State of Wisconsin would feel if United States Steel were able to get an exemption.

Dr. BENNETT. I'm not arguing, sir, with the fact that this is the way that it's set up and it does accomplish the purpose. My point is that we don't have the authority or the clout because the appeal goes higher than us in all cases. Companies know that the appeal goes to the Cost Accounting Standards Board and they have told us so.

Senator PROXMIRE. Does the Defense Department advocate that the Board should be relocated in the executive branch as the Department argued when this was an issue several years ago?

Dr. BENNETT. Our office doesn't have a position on that. If you'd like us to provide one for you we can. We hadn't considered it.

Senator PROXMIRE. Well, that was the DoD position, as I recall, when we passed the legislation. We insisted that it be in the GAO and it seems that's been a good idea.

Dr. BENNETT. We do have the separation of responsibility for supplies from the authority to contract in the case of Cost Accounting Standards.

Senator PROXMIRE. We have one good example with respect to the Cost Accounting Standards Board and with respect to this particular instance of the *United States Steel* case.

What's been the Defense Department's experience with the timeliness of Cost Accounting Standards Board actions on other waiver requests?

Dr. BENNETT. Very good. There has been no concern on our part about the responsiveness of the Cost Accounting Standards Board. I think we are more concerned with the fact that the administrative contracting officer, who is the contracting official, does not have the authority in order to get compliance with the Cost Accounting Standards and this then comes up through the hierarchy of the services, Department of Defense and the Cost Accounting Standards Board. This is an administrative cost.

Senator PROXMIRE. Now if the Defense Contract Audit Agency is reduced or merged with the Defense Contract Administration Service, won't the ability of the Defense Department to insure cost accounting compliance be seriously impaired?

Mr. BABIONE. I assume you're talking about the proposed merger recommended by the Commission on Government Procurement. We have taken the position that we are opposed to merging the Defense Contract Audit Agency with Defense Contract Administration Services. We forwarded that position as an official position several months ago.

Senator PROXMIRE. The Cost Accounting Standards Board legislation is not the only legislation which provides for exemptions from its cost disclosure requirements. The Truth-in-Negotiations Act provides for exemptions from such disclosures which are similar to those of CAS and apply in circumstances where there are catalog or market prices or prices set by law or regulation. I haven't heard how the United States Steel procurements were handled with regard to the requirements of the Truth-in-Negotiations Act, although I would suspect the company should have been required to submit the cost breakdowns. Why not?

Mr. BABIONE. This is the same question you asked earlier, Mr. Chairman, when I indicated to you that on the air flask which comprises two of the five purchase orders and the predominant amount of the money, $5.4 million, the contractor did agree informally to provide the cost data in accordance with Public Law 87–653. This agreement was prior to the time when the impasse developed on the inclusion of the Cost Accounting Standards of Public Law 91–379. So United States Steel was complying, in that instance, and it has indicated it will in the future.

Senator PROXMIRE. Can you provide for the record a summary of how many of these 500 Cost Standard violations were investigated? How many were settled and what were the penalties assessed in each one?

Mr. BABIONE. Yes, sir; we can do that. I'd like to indicate that according to the report that I was looking at there are not 500 still pending. There were 500 that occurred during a calendar year of which all but 200 were resolved. But we will provide that information to you.

Senator PROXMIRE. Well, give us a statistical breakdown of resolved and unresolved and so forth. (See exhibit 12 at p. 192.)

Mr. BABIONE. Yes, sir.

Senator PROXMIRE. Gentlemen, I want to conclude by saying that I think that the record that we have made this morning has made it very clear that the Cost Accounting Standards have been violated a number of times in the past. We have a record here that shows that the Cost Accounting Standards Board has been prompt and effective in securing compliance. We have a record that indicates that compliance in several cases has been achieved without significant cost or great cost and probably at very small cost, and we have a record also which indicates that one way or another, for one reason or another, the Defense Department has not been rigorous in enforcing Cost Accounting Standards and in reporting fully to the Cost Accounting Standards Board the violations and the details of the violations.

I feel very strongly, as an author of this bill, and as vice chairman of the Joint Committee which is responsible for oversight, that this law be carried out fully. I'm convinced, as Admiral Rickover indicated, that full compliance with this law would save an enormous amount of money for the taxpayer and would improve the integrity of the procurement process.

I'm happy to see that you're engaging in some activity in the Defense Department to instruct people in how to carry out the Cost Accounting Standards program but I'm very hopeful that we can make far greater progress in the future. I am also anxious to see that we make sure that under no circumstances can the defense of this country be denied its full strength on the grounds that there is not the authority in law to require a contractor to perform. One way or another, if there is that loophole in the law, that weakness in the law, we have to strengthen it and correct it. We'd like very much to get your assistance in doing that.

Thank you very much.

The hearings are recessed until tomorrow at 10 o'clock in this room.

[Whereupon, at 12:15 p.m., the hearing was recessed to reconvene at 10 a.m. Wednesday, August 21, 1975.]

(Additional questions for Dr. Bennett and answers supplied for the record, exhibit 20, p. 215.)

COST ACCOUNTING STANDARDS, WAIVERS, AND COMPLIANCE

WEDNESDAY, AUGUST 21, 1975

U.S. CONGRESS,
JOINT COMMITTEE ON DEFENSE PRODUCTION,
Washington, D.C.

The Joint Committee met at 10:10 a.m., pursuant to recess, in room 5302, Dirksen Senate Office Building, Senator William Proxmire (vice chairman of the Joint Committee) presiding.

Present: Senators Proxmire and Sparkman.

Senator PROXMIRE. The Joint Committee will come to order.

We are resuming hearings this morning on Defense Department and defense industry compliance with Cost Accounting Standards. Yesterday the Joint Committee heard testimony from Arthur Schoenhaut, Executive Secretary of the Cost Accounting Standards Board, and from Dr. John Bennett, Acting Assistant Secretary of Defense for Installations and Logistics.

This morning we will be privileged to hear from Mr. David Roderick, the President of United States Steel Corp., and from Adm. Hyman G. Rickover, Deputy Director for Nuclear Propulsion in the Naval Sea Systems Command and, I might say, the prime force behind the institution of Cost Accounting Standards.

A great deal is at stake here. We have a clash between the law that requires contractors to comply with uniform accounting standards backed up by the Cost Accounting Standards Board that has shown its determination to uphold the law and the power of one of the nation's biggest corporations, United States Steel. United States Steel is backed up by the most powerful agency in our Government, the Defense Department, which has been fighting for an exemption.

In an immediate and material sense a great deal is at stake, too. If the United States Steel Corp. were granted a waiver on a multi-million dollar contract of steel for submarines vital to our defense, what possible grounds would remain for the Board to insist on compliance with the law by any other firm? And the collapse of uniform Cost Accounting Standards could cost the Government and the American taxpayer literally billions of dollars a year.

While it is true that the instant defiance by United States Steel seems to have been settled, the assault on the Board seems to be just beginning. The Board's ability to resist the assault now underway will represent a very considerable test.

The Joint Committee's inquiry is not limited to the recent case of a request for a waiver from these Standards for United States Steel. This is not an isolated case. Rather, it may be the opening salvo in a

major assault on Cost Accounting Standards by a large segment of basic industry.

Mr. Schcenhaut in his testimony yesterday mentioned several other requests for waivers or exemptions pending before the Cost Accounting Standards Board or expected to come before the Board in the near future. Among the companies seeking waivers or exemptions are such primary producers as Ingersoll-Rand, the Aluminum Co. of America, and Ladish Steel Co. of Milwaukee in my home state.

In addition, we understand that General Dynamics has been unable to complete 19 orders with United States Steel totaling over $18 million in value because of big steel's refusal to accept the Cost Accounting Standards contract clause. These include the five subcontracts on which a waiver was recently refused by the Cost Accounting Standards Board.

The testimony yesterday revealed what I can only characterize as a tepid attitude on the part of the Department of Defense toward requiring firms to accept and live up to these Cost Accounting Standards and similar provisions. Although the Cost Accounting Standards Board has the authority to make final determinations on technical questions relating to the Standards, it is ultimately the procurement agencies themselves which must insure that the Standards are adhered to and that all contracts requiring such Standards contain them.

Thus, I think there is some cause for alarm when we view the record of the Defense Department in this area. Its track record overall, and particularly its actions in the present United States Steel case, leave quite a few questions about its willingness to act with vigor and determination.

As I pointed out yesterday, these Cost Accounting Standards are among the very few ways we have of insuring that public money is spent wisely and fairly. They require that companies tell the Government how they determine their prices on contracts where there is no competitive bidding.

It is the clear duty of all public officials who are involved with contracts and procurement to insure full compliance with these Standards. That is the point of these hearings.

Our first witness today will be, as I said, Mr. David Roderick. Mr. Roderick became the president of United States Steel on the first of this month after serving as chairman of the company's finance committee.

Mr. Roderick, come forward, sir.

STATEMENT OF DAVID M. RODERICK, PRESIDENT, UNITED STATES STEEL CORP., ACCOMPANIED BY R. L. WATTS, SENIOR GENERAL ATTORNEY, AND B. D. SMITH, VICE PRESIDENT AND COMPTROLLER

Mr. RODERICK. Thank you, Senator Proxmire.

Senator PROXMIRE. We hope, Mr. Roderick, that your accession to the presidency of United States Steel presages a new era of company-Government cooperation. And I hope that the agreement that was worked out last week is the first step in that direction, though I feel I should point out that the agreement appears to be a very heavily qualified and tentative step in that direction.

In accordance with committee rules, Mr. Roderick, I will ask you to spend 10 minutes summarizing your written testimony. After that we will proceed to questions.

If you would introduce the gentlemen who are with you this morning, we would appreciate it.

Mr. RODERICK. Thank you, Senator.

I am David M. Roderick, President of United States Steel Corp. With me today are Mr. R. L. Watts, Senior General Attorney, and Mr. B. D. Smith, Vice President and Comptroller of United States Steel. Both of these gentlemen have been deeply involved in this immediate problem.

I appreciate this opportunity to appear before you and clarify United State's Steel position in this matter of a request for waiver of the application of Cost Accounting Standards to the small amount of our defense business involved

First, let me cite a few facts. United States Steel is not primarily a defense contractor. Defense production is a de minimis amount of our total business. In 1974 United States Steel shipped 25.7 million tons of steel products. Our total sales and revenues were $9 billion. Of this total nearly $8 billion was revenues from the sale of steel products.

The principal defense products we sell currently are plates and air flasks used in the submarine program. These air flasks are fabricated from alloy pipe of the same steel grade made for other commercial customers.

During 1974 the alloy pipe for air flasks amounted to less than 200 tons or approximately one-tenth of 1 percent of our total alloy pipe and tubing tonnage. These air flasks are produced at our Christy Park Works at McKeesport, Pa. Although the volume of this business will vary widely depending on defense requirements, currently it is running at about 10 percent of this plant's business.

The other principal product is nickel-chrome-moly plates produced in what is known as the HY series. Some of these plates are fabricated by other companies into components for the submarines. Our sales of the HY series plates in 1974 were about 11,000 tons or less than one-third of 1 percent of our plate business. In terms of revenues HY series plate represented less than 1 percent of our total plate revenues. Revenues from HY plates produced at Homstead, Pa., our principal HY series producer, represent less than 1.5 percent of the total sales of this plant in 1974.

Primarily, in view of these facts, we decided in 1974 to seek a waiver of the Cost Accounting Standards on a number of subcontracts with Electric Boat. Another consideration underlying our request was the question of our ability to comply with the existing and prospective Cost Accounting Standards.

We have an excellent, well-engineered standard cost system developed over many years. It is designed to meet, and it does meet, our business needs for cost information, for operating control, and for planning purposes. With the small amount of defense business we have it did not seem prudent to commit ourselves to standards yet to come which might require an overhaul of the system to meet the requirements, particularly if required to accommodate business that is not all that attractive operationally or financially.

So in May 1974, following the Cost Accounting Standards Board change in the threshold for filing of disclosure statements, we requested Electric Boat to obtain an exemption. Discussions on this matter occurred over the next several months. Our letter, dated December 13, 1974, asked Electric Boat to request a waiver and contained, as required by Government regulations, an unequivocal statement that we refuse to accept contracts containing the cost accounting clause.

Let me emphatically state that this was only a refusal to contractually accept the Cost Accounting requirements. Let me also state unequivocally that United States Steel has continued to produce and ship the steels for the submarine program required by the prime contractor, Electric Boat. In fact, we have already produced some material and scheduled others for production needed for delivery later this year against two pending orders.

These orders cannot be formally acknowledged until the detail specifications have been finalized by Electric Boat. Some of the design features have not yet been worked out. Nevertheless, we expect to meet Electric Boat delivery requirements on these orders.

Returning to the matter of our waiver request, the Department of Defense submission to the Cost Accounting Standards Board was dated July 14, 1975—more than 6 months after our December 13, 1974, request. We were not consulted as to the facts alleged in the Department of Defense request.

Frankly we were surprised to hear on July 31 of this year by your public release, Senator, that the waiver request had been denied. I would like to emphasize again that throughout this entire period we have continued, and are continuing, to produce and ship the Navy requirements.

We believe the record of these hearings should contain the facts and, accordingly, request your approval to include in the record an analysis of the information submitted by the Defense Department in its request for the waiver.

Senator PROXMIRE. Yes, we are happy to do this and without objection we will include that in the record.

Mr. RODERICK. Thank you very much. (See exhibit 13 at p. 192.)

We were informed by Electric Boat on August 1, 1975, that the requested waiver had been denied. United States Steel notified Electric Boat on August 7, 1975, as follows, and I quote:

> Re your telegraph of August 1. This morning we met with Elmer B. Staats, Chairman of the Cost Accounting Standards Board, and members of his staff, with regard to its denial of our request. We are advised there will be a further meeting to seek a solution to this problem satisfactory to all concerned.
>
> You may be assured that there will be no delay in meeting our delivery promises on your orders on our books. We would suggest your technical representatives advise us as promptly as possible final specifications to apply to the orders you have indicated you wish to place with us for the flasks for your submarine program so that they may be processed to meet your delivery requirements.

I request that a copy of this telegram be entered into the record. (See exhibit 14 at p. 194.)

Senator PROXMIRE. Yes; that will be done, Mr. Roderick.

Mr. RODERICK. Thank you.

Representatives of United States Steel met on Thursday, August 7, 1975, with Mr. Staats and representatives of the Cost

Accounting Standards Board staff to clarify to them United States Steel's position since the presentation to the CAS Board was misleading. We met again on Tuesday, August 12, with the Board staff, representatives of the Navy and the Defense Department. On Thursday and Friday, August 14 and 15, we met with the Board's staff and representatives of the Defense Contract Audit Agency, and reviewed in detail our cost system and the problems of complying with CAS standards.

Out of these meetings have come clarification and understanding of the Cost Accounting Standards as they relate to United States Steel's longstanding, well-engineered standard cost system. After these reviews we stated our position in our August 15, 1975, letter to the Cost Accounting Standards Board, which you read into the record yesterday, Senator, but we request that it be entered into the record with our other exhibits. (See exhibit 15 at p. 194.)

Senator PROXMIRE. Without objection.

Mr. RODERICK. To us the aspects underlying these hearings appear to be threefold:

First, there has been a concern that United States Steel might cut off shipments of products needed for the submarine program. As I have pointed out, we have not done so and have no intention of doing so. It is not fair in our opinion to characterize that our request for a waiver—"has attempted to blackmail the Navy"—by the withholding of supply. Our actions categorically refute this charge.

The second concern seems to be that United States Steel is now the sole source of supply for certain submarine requirements. This concern is also without merit. It may be true, as stated by the Department of Defense, that Electric Boat received no other offers in its solicitation for the purchase orders listed in the waiver request. However, I find it difficult to understand how the procurement of these products under the present conditions of depressed demand and unemployment has reached the point of dependence upon a sole source of supply, particularly for HY-80 plate. The existence of at least three sources capable of supplying this product is a long-established, well-demonstrated fact, and I am sure additional plate producers have, or could develop, such capability.

It seems to me that the policies and procedures for defense procurement of steel, as well as many other products of American industry, should be directed toward developing and attracting competition from a number of sources, both as a matter of national security as well as sound long-range economics.

Perhaps there are some defense items that can only be supplied by a sole source, but I seriously doubt that submarine toroid rings, for example, is one of them. In the past, Newport News Shipbuilding & Dry Dock Co. has fabricated the toroid rings for its own construction of submarines. I understand also that Electric Boat has directly subcontracted the fabrication of toroid rings of the *Trident* submarine to Chicago Bridge & Iron Co. without United States Steel's contractual involvement.

Thus, past history indicates several possibilities of Electric Boat subcontracting some of its toroid ring requirements to companies other than United States Steel.

In short, it just doesn't seem realistic to contend that United States Steel has to be a sole source supplier of either toroid rings or HY–80 plates. The objective of maximizing competition should be vigorously pursued in all defense procurements and I firmly believe that competitive bidding, rather than negotiation of price based on costs, will, in the long run, produce the lowest cost of national defense.

In the case of the air flasks there is no problem in obtaining the steel for them in that it is a widely used commercial grade. For example, last year over 90 percent of our shipments of this grade of steel went to commercial customers. While we apparently presently are the only fabricator of this steel into submarine air flasks, the Department of Defense request for our waiver acknowledges interest on the part of one other fabricator. However, this other prospective source was dismissed because of the company's lack of experience and much higher bid than United States Steel.

Unfortunately, such rationale would only perpetuate the dependency of the submarine program on our aging Christy Park operation. I believe the Department of Defense can and should focus on the development of competing sources of supply for air flask fabrication.

The third concern has to do with the often repeated but untrue allegations of illegal pricing of HY–80 that are once again being made by the Department of Defense in its request for the waiver. We once again categorically deny these charges.

Some seem to forget that all we are dealing with are allegations which have not now or ever in the past been sustained. As the Department of Defense knows and admits, this charge was exhaustively looked into by the Federal Trade Commission in the late 1960's and no evidence of unlawful practices was found. A new attempt to substantiate these allegations is now being made by the Federal Trade Commission in a pending lawsuit that relates to compliance with a 1951 consent decree issued by that agency.

Let me conclude these remarks with a few summary observations.

The Department of Defense alleges that since the enactment of the Truth-in-Negotiations Act of 1962 "* * * there has been a continuing problem involving the inability of the Navy and its prime contractor to obtain cost or pricing data from United States Steel Corp."

As noted in exhibit 13, our record in this regard refutes this charge.

As to our actions in the past year, we requested a waiver of the Cost Accounting Standards clause in accordance with the procedure required by the regulations. We assumed that in giving the CASB the authority to grant exemptions to Standards, the Congress was indicating its desire that the Standards be applied in a reasonable and sensible manner.

We continue to feel that it is reasonable and sensible to exempt contracts where there is clear evidence—as there is with these subcontracts of competing sources of supply; or where—as is true here—a de minimus amount of the successful bidder's overall business is involved. Failure to recognize these principles can only tend to diminish rather than enlarge the choices of supply available to the Defense Department. But let me again say, Senator, we did not stop production nor stop shipments of any critical materials to the Navy, nor do we intend to.

United States Steel has had a long history of working very closely with the Defense Department in helping with both technical problems and the supply of materials. Our posture has always been one of rendering assistance to the nation's defense effort and our vast research facilities provide a continuing source of cooperative effort in this regard. Our record in this overall area should be one for which we receive commendation and not public criticism.

Thank you, Senator, and I would be very pleased along with my associates to answer any questions or offer any clarifications.

[Prepared statement of Mr. Roderick follows:]

STATEMENT OF DAVID M. RODERICK, PRESIDENT OF UNITED STATES STEEL CORPORATION, BEFORE THE JOINT COMMITTEE ON DEFENSE PRODUCTION, AUGUST 21, 1975

My name is David M. Roderick, President of United States Steel Corporation. With me today are Mr. R. L. Watts, Senior General Attorney, and Mr. B. D. Smith, Vice President and Comptroller, of U.S. Steel.

I appreciate this opportunity to appear before you and clarify U.S. Steel's position in this matter of a request for waiver of the application of Cost Accounting Standards to the small amount of our defense business involved.

First, let me cite a few facts. U.S. Steel is not primarily a defense contractor. Defense production is a de-minimus amount of our total business. In 1974, U.S. Steel shipped 25.7 million tons of steel products. Our total sales and revenues were $9 billion. Of this total, nearly $8 billion was revenues from the sale of steel products. The principal defense products we sell currently are plates and air flasks used in the submarine program. These air flasks are fabricated from alloy pipe of the same steel grade made for other commercial customers. During 1974, the alloy pipe for air flasks amounted to less than 200 tons or approximately 1/10 of 1% of our total alloy pipe and tubing tonnage. These air flasks are produced at our Christy Park Works at McKeesport, Pennsylvania. Although the volume of this business will vary widely depending on defense requirements, currently it is running about 10% of this plant's sales.

The other principal product is nickel-chrome-moly plates produced in what is known as the HY series. Some of these plates are fabricated by other companies into components of the submarines. Our sales of the HY series plates in 1974 were about 11,000 tons or less than ⅓ of 1% of our total plate tonnage. In terms of revenues, HY series plate represented less than 1% of our total plate revenues. Revenues from HY plates produced at Homestead, Pennsylvania—our principal HY series producer—represent less than 1½% of the total sales of this plant in 1974.

Primarly, in view of these facts, we decided in 1974 to seek a waiver of the Cost Accounting Standards on a number of subcontracts with Electric Boat. Another consideration underlying our request was the question of our ability to comply with the existing and prospective Cost Accounting Standards. We have an excellent, well engineered standard cost system developed over many years. It is designed to meet, and it does meet, our business needs for cost information, for operating control, and for planning purposes. With the small amount of defense business we have, it did not seem prudent to commit ourselves to standards yet to come which might require an overhaul of the system to meet the requirements, particularly if required to accommodate business that is not all that attractive operationally or financially.

So in May 1974, following the Cost Accounting Standards Board change in the threshold for filing of disclosure statements, we requested Electric Boat to obtain an exemption. Discussions on this matter occurred over the next few months. Our letter dated December 13, 1974, asked Electric Boat to request a waiver and contained, as required by the government regulations, an "unequivocal" statement that we refuse to accept contracts containing the cost accounting clause.

Let me state emphatically that this was only a refusal to contractually accept the Cost Accounting Standards requirements. Let me also state unequivocally that U.S. Steel has continued to produce and ship the steels for the submarine program required by the prime contractor, Electric Boat.

In fact, we have already produced some material and scheduled others for production needed for delivery later this year against two pending orders. These

orders cannot be formally acknowledged until the detail specifications have been finalized by Electric Boat. Some of the design features have not yet been worked out. Nevertheless, we expect to meet Electric Boat delivery requirements on these orders.

Returning to the matter of our waiver request, the Department of Defense submission to the Cost Accounting Standards Board was dated July 14, 1975—more than six months after our December 13, 1974 request. We were not consulted as to the facts alleged in the Department of Defense request. Frankly, we were surprised to hear on July 31, 1975, by Senator Proxmire's release that the waiver request had been denied.

I would like to emphasize again that throughout this entire period we have continued, and are continuing, to produce and ship the Navy requirements.

We believe the record of these hearings should contain the facts and, accordingly, request your approval to include in the record an analysis of the information submitted by the Defense Department in its request for the waiver. This attachment is marked as Exhibit 13.

We were informed by Electric Boat on August 1, 1975, that the requested waiver had been denied. U. S. Steel notified Electric Boat on August 7, 1975 as follows, and I quote:

"Re your telegraph of August 1. This morning we met with Elmer B. Staats, Chairman of the Cost Accounting Standards Board, and members of his staff, with regard to its denial of our request. We are advised there will be a further meeting to seek a solution to this problem satisfactory to all concerned. You may be assured that there will be no delay in meeting our delivery promises on your orders on our books. We would suggest your technical representatives advise us as promptly as possible final specifications to apply to the orders you have indicated you wish to place with us for the flasks for your submarine program so that they may be processed to meet your delivery requirements."

I request that a copy of this telegram be entered into the record as Exhibit 14.

Representatives of U. S. Steel met on Thursday, August 7, with Mr. Staats and representatives of the Cost Accounting Standards Board staff to clarify to them U. S. Steel's position since the presentation to the CAS Board was misleading. We met again on Tuesday, August 12, with the Board staff, representatives of the Navy and the Defense Department. On Thursday and Friday, August 14 and 15, we met with the Board's staff and representatives of the Defense Contract Audit Agency, and reviewed in detail our cost system and the problems of complying with standards.

Out of these meetings have come clarification and understanding of the Cost Accounting Standards as they relate to U. S. Steel's longstanding, well engineered standard cost system.

After these reviews, we stated in part in our August 15, 1975 letter to the Cost Accounting Standards Board:

"We intend to comply with applicable requirements of the Cost Accounting Standards Board in any appropriate instance where statutory or regulatory exemptions are not available in connection with contracts or subcontracts accepted by U. S. Steel. As we have previously informed you, U. S. Steel has assured Electric Boat that there will be no delay in meeting our delivery promises because of any possible problems in working out the applicability of Cost Accounting Standards."

This letter deals with one aspect of the subject matter of these hearings, and we request that it be entered into the record as Exhibit 15.

To us, the aspects underlying these hearings appear to be threefold:

First, there has been a concern that U.S. Steel might cut off shipments of products needed for the submarine program. As I have pointed out, we have not done so and have no intention of doing so. It is not fair to characterize that our request for a waiver—quote—has attempted to blackmail the Navy—unquote—by the withholding of supply. Our actions categorically refute this charge.

The second concern seems to be that U.S. Steel is now the sole source of supply for certain submarine requirements. This concern is also without merit. It may be true, as stated by Department of Defense, that Electric Boat received no other offers in its solicitation for the purchase orders listed in the waiver request. However, I find it difficult to understand how the procurement of these products under the present conditions of depressed demand and unemployment has reached the point of dependence upon a sole source of supply—particularly for HY-80 plate. The existence of at least three sources capable of supplying this

product is a long established, well demonstrated fact, and I am sure additional plate producers have, or could develop, such capability.

It seems to me that the policies and procedures for defense procurement of steel, as well as many other products of American industry, should be directed toward developing and attracting competition from a number of sources—both as a matter of national security as well as sound long range economics.

Perhaps there are some defense items that can only be supplied by a sole source, but I seriously doubt that submarine toroid rings, for example, is one of them. In the past Newport News Shipbuilding and Dry Dock Company has fabricated the toroid rings for its own construction of submarines. I understand also that Electric Boat has directly subcontracted the fabrication of toroid rings of the Trident submarine to Chicago Bridge and Iron Company without U.S. Steel contractual involvement.

In the 1960's, we understand that Lukens Steel Company bid competitively against U.S. Steel for toroid rings, and on different occasions they were awarded contracts for performing all of the work in-house or by subcontracting with Newport News or with Chicago Bridge and Iron Company. Thus past history indicates several possibilities of Electric Boat subcontracting some of its toroid ring requirements to companies other than U.S. Steel.

In short, it just doesn't seem realistic to contend that U.S. Steel has to be the sole source supplier of either toroid rings or HY–80 plates. Perhaps there should be more effort by the Department of Defense to coordinate procurements, or at least conduct the necessary missionary work, to assure the availability of multiple sources for response to the solicitation of bids for these products. The objective of maximizing competition should be vigorously pursued in all defense procurements, and I firmly believe that competitive bidding, rather than negotiation of price based on costs, will in the long run produce the lowest cost of national defense.

In the case of the air flasks, there is no problem in obtaining the steel for them as it is a widely used commercial grade. For example, last year over 90% of our shipments of this grade of steel went to commercial customers. While we apparently presently are the only fabricator of this steel into submarine air flasks at present, the Department of Defense request for our waiver acknowledges interest on the part of one other fabricator—Taylor Forge Company. However, this prospective source was dismissed because of the company's lack of experience and much higher bid than that of U.S. Steel. Unfortunately, such rationale would only perpetuate the dependency of the submarine program on our aging Christy Park operation. I believe the Department of Defense can and should focus on the development of competing sources of supply for air flask fabrication.

The third concern has to do with the often repeated but untrue allegations of illegal pricing of HY–80 that are once again being made by the Department of Defense in its request for the waiver.

We once again categorically deny these charges. Some seem to forget that all we are dealing with are allegations which have not now or ever in the past been sustained. As the Department of Defense knows and admits, this charge was exhaustively looked into by the Federal Trade Commission in the late 1960's and no evidence of unlawful practices was found. A new attempt to substantiate these allegations is now being made by the Federal Trade Commission in a pending lawsuit that relates to compliance with a 1951 consent order issued by that agency.

Let me conclude these remarks with a few summary observations.

The Department of Defense alleges that since the enactment of the Truth-in-Negotiation Act of 1962 "... there has been a continuing problem involving the inability of the Navy and its prime contractor to obtain cost or pricing data from United States Steel Corporation."

As noted in Exhibit A, our record in this regard refutes this charge.

As to our actions in the past year, we requested a waiver of the Cost Accounting Standards clause in accordance with the procedure required by regulations. We assumed that in giving the CASB the authority to grant exemptions to standards, the Congress was indicating its desire that the standards be applied in a reasonable and sensible manner. We continue to feel that it is reasonable and sensible to exempt contracts where there is clear evidence—as there is with these subcontracts of competing sources of supply; or where—as is true here—a de-minimus amount of the successful bidder's overall business is involved. Failure

to recognize these principles can only tend to diminish rather than enlarge the choices of supply available to the Defense Department. But let me again say, we did not stop production, nor stop shipments, nor do we intend to.

U.S. Steel has had a long history of working very closely with the Defense Department in helping with both technical problems and the supply of materials. Our posture has always been one of rendering assistance to the Nation's defense effort. Our vast research facilities provide a continuing source of cooperative effort in this regard. Our record in this overall area should be one for which we receive commendation and not public criticism.

Thank you.

Senator PROXMIRE. Thank you very much for a strong and clear statement, Mr. Roderick. I think your statement and the statements that preceded you demonstrate the great value of public hearings in getting both sides and hearing differing views. Because your statement does conflict on several significant points with that given the committee from witnesses of the Department of Defense, I am unable to say who may be correct in each area, but I am strongly of the opinion that neither you nor the Department of Defense has told all of the story on each of the points in contention.

Without the full story I don't believe that the committee can hope to make a determination as to proper enforcement and compliance with Cost Accounting Standards and similar provisions of the law, but I am prepared to keep these hearings open until we have reached a satisfactory understanding. I hope we can proceed today in a manner that will bring out all the facts in the situation and will thoroughly ventilate the position of the parties concerned.

In this context I would like to read a very specific question.

In your testimony and in exhibit 13 you are at some pains to point out that United States Steel may not be the sole source for certain steel products required for our submarine programs, although the alternatives may be highly conjectural. Yet, on the other hand, last December you requested a waiver from the Cost Accounting Standards on one of the criteria, which is that the supplier be the only source for the needed product.

This is a primary requirement for approval of a waiver request. Either you were wrong in requesting that waiver because you were not the sole source, as you maintain this morning, or you were right and what you told us this morning is somehow in error.

Can you explain this discrepancy between your waiver request and your testimony right now?

Mr. RODERICK. Certainly, Senator, I would be very pleased to.

No. 1, the waiver request that we made, it is very difficult for us when we are bidding on a job, for example, to really know if other people are bidding on that job. For example, when we bid on a job dealing wih HY–80 steel we know of at least three other sources that are capable of bidding. However, when our contractor tells us that we have been the only bid received, we assume that that is right.

I can't explain why we would be the only bidder in those situations and I would think that in today's environment of high unemployment and people looking for business it is almost inconceivable to me in the case of HY–80 why we would be the sole source.

The toroid rings, I think I pointed that out. We really perform no function in the toroid rings at all other than to supply the steel. That contention in my opinion, that Chicago Bridge & Iron would not issue or do this work for others, is clearly not founded.

They are doing the work for Electric Boat currently directly. They have done the work for others, Newport News has done it directly themselves. The only function we have to play in the construction of toroid rings is to supply the HY–80 steel. So we are obviously not the sole source there other than supplying the steel, even though the record indicates that we have been——

Senator PROXMIRE. If you are not the sole source, then you don't qualify for a waiver, Mr. Roderick.

Mr. RODERICK. We believed, Senator, that in each case we asked for the waiver—when we initiated the waiver, it is primarily, of course, over the air flask. The air flask, as you know, is not made of HY–80.

We readily have indicated that apparently we are the sole source of supply on the air flask and we don't think we should be. We know other people are capable of supplying those air flasks, but they are all being placed on our Christy Works facility.

So we are a sole source in that case and our waiver request certainly reflects those orders on Christy Park.

Now, if in addition no other bid is received, we are again the sole source, Senator. But it doesn't mean that we are the sole capable source. It merely means that bids have not been received from other people, which makes us the sole source under the regulations.

Senator PROXMIRE. At the time you requested the waiver you knew you were the sole source. That is, the contracts were let to United States Steel far prior to December 1974 when the waiver was requested. So that the possible competition later on was not relevant, is that right?

Mr. RODERICK. I don't know whether I understand your point, Senator.

Senator PROXMIRE. Well, by the time that you requested the waiver——

Mr. RODERICK. In December.

Senator PROXMIRE [continuing]. The only source available to Electric Boat and to the Navy of the kind of steel needed for construction of these submarines was from United States Steel Corp. at that time. That is why you were the sole source?

Mr. RODERICK. That's right, it is our understanding that apparently other people did not bid on that HY–80, which again makes us the sole source on that bid, but not the sole source capable.

Senator PROXMIRE. You knew at that time. You had the contract. You had not signed it but you had the contract.

Mr. RODERICK. That is right. We accepted the order for delivery subject to the granting of a waiver of the Cost Accounting Standards. And we made deliveries in the interim.

Senator PROXMIRE. My point is you had the Defense Department and Electric Boat over a barrel.

Mr. RODERICK. I don't know what you mean by "over a barrel."

Senator PROXMIRE. They either agreed to go along with your request for a waiving of the requirements to comply with CAS, or you were at least in the position to deny them having steel which they need to construct the submarines.

Mr. RODERICK. We would be in a position to do that, Senator.

Senator PROXMIRE. That is right.

Mr. RODERICK. I think the important thing is that we did not do that.

Senator PROXMIRE. Well, that is something we have to develop later on.

Mr. RODERICK. We are continuing to process orders that we currently have and we are actively soliciting orders. As a matter of fact, if you know of any Defense Department requirement, we would be delighted if you would send them to us, we are looking for business. We are not trying to avoid business.

Senator PROXMIRE. At the time of the waiver request, you were the sole source, that's the point.

Mr. RODERICK. To our belief on air flasks there is no question about that. On HY–80 we have to assume that no other person bid and, therefore, we would be the sole source.

Senator PROXMIRE. On HY–80, 80 percent of that capacity is produced by United States Steel, and I understand that the Defense Department is already buying most of the rest of HY–80; there wasn't the amount available to secure it. To say there are other sources may be technically accurate but misleading inasmuch as the supply wasn't adequate.

Mr. RODERICK. Senator, I think the statistics that may be misleading are your 80 percent.

From what we can see of HY–80—and this is a difficult thing to get your arms around—we think the total market for that steel is somewhere in the neighborhood of 23,000 to maybe 30,000 tons a year.

We think that if some of these other competitors of ours would desire to take more of this business they could supply more. As a matter of fact, our commercial intelligence indicates that we probably don't supply more than 50 percent of the HY–80 plate currently. As a matter of fact, we doubt if we necessarily even supply as much as 50 percent.

Senator PROXMIRE. At any rate there is a point of difference in your testimony. You were the sole source; the basis for your request of a waiver was that you were the sole source and at the time the waiver was requested you were in fact the sole source and you were in a position to make a demand for exemption or waiver from the CAS standards with considerable power.

Mr. RODERICK. A request.

Senator PROXMIRE. Let me move to some other points. Let me turn to the agreement of last week. The letter from Mr. Smith of United States Steel to Mr. Schoenhaut seems to make three points as follows:

First, United States Steel's accounting system is compatible with current Cost Accounting Standards requirements.

Second, United States Steel will comply with applicable Cost Accounting Standards;

And third, United States Steel will make Electric Boat deliveries without delay.

Is that a fair summary of the letter, Mr. Roderick. Would you like me to repeat the three points? (Complete letter, exhibit 15, p. 194.)

Mr. RODERICK. No; I believe that is a good summary of it, and I think an accurate summary.

Senator PROXMIRE. Is it your belief and intention that the corporation will honor and live up to these pledges reserving your right to consider future Standards on their merits?

Mr. RODERICK. Yes.

Senator PROXMIRE. What bothers me about the letter is this. It reads like a State Department position paper, frankly—heavy on the paper but light on the position. Let me be specific.

Mr. Smith, when you say we are presently of the opinion, does that mean your opinion may change next week or next month. You say "presently?"

Mr. SMITH. It was not intended to imply any change at all, sir.

Senator PROXMIRE. Why did you use that terminology?

Mr. SMITH. It is examining it in light of the facts available to us and the standards that exist at this time. We would have to look at each one as they are promulgated to see what position we would take.

Senator PROXMIRE. You would have to look at each one as promulgated?

Mr. SMITH. Each of the new Standards coming out.

Senator PROXMIRE. Any new Standards.

Mr. SMITH. Yes.

Senator PROXMIRE. When you say that Cost Accounting Standards are compatible with our accounting system "as presently constituted and structured," does that mean that next year you will reconstitute and restructure your system and forget about the Cost Accounting Standards in the contracts?

Mr. SMITH. No, sir. It means that the system that we now have is compatible with the requirements of Cost Accounting Standards.

Senator PROXMIRE. Does that mean that if the Cost Accounting Standards change—and I would understand that—you would have to take another look and your position would be proper in doing so? But can I assume that you are not hedging this so that you would change your own Standards and, therefore say that it was not compatible?

Mr. SMITH. There is no hedge intended at all in that, sir.

Senator PROXMIRE. All right.

Now, when you say you intend to comply with applicable requirements "in any appropriate instance," does that mean that you are reserving judgment about compliance, applicability and appropriateness of the current Standards?

Mr. SMITH. No, sir; we are reserving judgment as to whether or not a specific contract actually requires the Cost Accounting Standards clause. We don't always know that. We are dependent upon the prime contractor.

Mr. RODERICK. Again, Senator, I think it is very important to point out that under all conditions the Cost Accounting Standards do not apply and we really have to work jointly with the contractor to find out really where they do apply and what we have done, what we are doing as we had done yesterday, we have made an arrangement with Electric Boat to sit down with them, hopefully tomorrow or Monday, to go through each of these contracts and where it is deemed, where the facts are there that we as a matter of law and regulations are subject to the Standards, we are going to comply. It is a matter of law. It is also part of our purchase order acceptance.

Senator PROXMIRE. I think I understand what you and Mr. Smtih have just told me. This would apply strictly to changes that might be made in the future in the Cost Accounting Standards offered by the Government. But you wouldn't alter your Standards and then say that

you would not longer comply, because of your own United States Steel standards being different.

Mr. RODERICK. Our standard cost system is one that we have had for many years and the only reason we really modify it is to constantly keep it up to date for current operating practice and current——

Senator PROXMIRE. This seems to button it up about as firmly as you can as far as the United States Steel providing two things, (1) the steel to the Electric Boat for these submarines; (2) compliance with the Cost Accounting Standards in connection with that particular contract. Is that right?

Mr. RODERICK. That is right, Senator.

Senator PROXMIRE. When you say "there will be no delay in meeting our delivery promises because of any possible problems in working out applicability of Cost Accounting Standards," does that mean you will continue to deliver steel without delay?

Mr. RODERICK. Yes, we have—where we have accepted orders subject to the Cost Accounting Standards clause—continued to deliver on those contracts, Senator.

On the contracts that are pending, the only thing that is holding them up is not the applicability of the Cost Accounting Standards on these three sets of submarines. Our problem is getting the final specifications pinned down with Electric Boat and when that is done and we have had people meeting with them as recently as last week, we would then be in a position to finalize our quote and accept the order and, naturally, with that order accept the Cost Accounting Standards applicable to it.

So in the interim—and I think this is important, I understand your concern and the concern of the Navy—but we are not even waiting for the receipt of the order in its final form. We have gone ahead and had the steel necessary to comply with those orders or to complete those orders, that steel has been rolled at our McKeesport plant. It has been delivered to Christy Park and it is sitting there waiting to be processed, even though we don't have an order. But we are actively trying to finalize those orders so we can get it into our production schedule.

Senator PROXMIRE. Further, in regard to your assurances to Electric Boat, does this mean that you have signed or will soon sign the five subcontracts for which a waiver was requested leaving aside the matter of specifications for the moment?

Mr. RODERICK. I think, Senator, if you wish, I could read this. It is a very short telegram we sent them yesterday. I think it will clarify that point for you.

Senator PROXMIRE. All right.

Mr. RODERICK. They had sent us a telegram asking us if we could categorically accept on the nine orders that we had, if we would accept the Cost Accounting Standards. This is our reply:

> In respect to your telegrams of August 19 and 20, we shall be happy to have our representatives sit down with you and any other parties who should be present at your earliest opportunity to determine the applicability of the Cost Accounting Standards Board and the Truth-in-Negotiation Act requirements to each of the orders listed in your telegram of August 19th. As you no doubt know, our standard form of order acknowledgement provides "any clause required to be included in a contract of this type by any applicable law or administrative regulation having the effect of law shall be deemed to be incorporated herein."

In other words, it is incorporated in our acceptance automatically.

Accordingly, we shall accept the requirements of the Cost Accounting Standards Board and the Truth-in-Negotiation Act requirements on any order on which they are in fact applicable.

Senator PROXMIRE. Well, that—the way you read that and with your skilled emphasis, I think it sounds awfully good.

Mr. RODERICK. It is good.

Senator PROXMIRE. And it may be very good. But let me go back a little bit about the language that still seems to be a very considerable hedge.

You say having indicated in your previous communication to Mr. Schoenhaut, Mr. Smith's letter, that you are ready to proceed——

Mr. RODERICK. Yes.

Senator PROXMIRE. You now say that you will be happy to have your representatives sit down with other parties who should be present at your earliest opportunity to determine the applicability of the Cost Accounting Standards Board and Truth-in-Negotiation Act requirements.

Mr. RODERICK. Yes, for example——

Senator PROXMIRE. That seems to me to be still giving you a very considerable out.

Mr. RODERICK. Not really, Senator. The only purpose of this is we don't want to agree to comply where the Cost Accounting Standards clearly do not apply. For example, we need to clarify with our contractor whether we were the sole bidder, whether there were competitive bids, because they are the only ones who can tell us that. We don't know in these cases. So our sole purpose is that if they apply, we certainly intend to comply. We are not trying to hedge.

One example, one of—two of their orders deal with, according to our information at this point, regular carbon plate. It is a catalog item. We are sure they received other bids on this. We assume that we were granted that order on the basis of competitive bidding of a catalog item.

In this case the CAS would probably not apply. Now, that is all we are trying to clarify, that where it applies there is no question or no intent to be cute or clever on our part, we are going to go ahead and we are going to comply.

We really—I would be very happy to do this, Senator, on the five orders that—I don't know whether five you refer to—but on all of the orders that we have with Electric Boat pending following our meeting with them, and we will do that as soon as they are ready to do that, hopefully, as far as we are concerned, tomorrow is not too soon, we will be very happy to give your committee a report of just exactly what conclusions were reached on each of those orders. I am sure on the orders that you have in mind, there is little doubt in my mind that the Cost Accounting Standards will apply and we will comply.

Senator PROXMIRE. Mr. Roderick, I understand why a businessman who has the enormous responsibility you have for such a very important corporation has to be extremely careful and cautious. But I wonder how far we can go? Here is a situation where you have made this agreement, moved into it, a year ago. Eight months ago in Decem-

ber the waiver was filed. As a matter of fact, in May it was originally requested.

Mr. RODERICK. That is correct, sir.

Senator PROXMIRE. And you have been dealing with this situation for a long, long time and yet you can't tell us unequivocally that you will go ahead and agree to sign the contract and abide by the Cost Accounting Standards required for this contract. It seems to me you would be in a position just to tell us.

Mr. RODERICK. I don't think——

Senator PROXMIRE. Without reservation.

Mr. RODERICK. There is no reservation at all. Where the Cost Accounting Standards apply, we are going to——

Senator PROXMIRE. You should know whether they apply or not now. Don't you think they apply?

Mr. RODERICK. Our problem is, Senator, that we can't determine that unilaterally. We only know that we bid. Now there are other circumstances, if there are other bidders and it is competitive bid and it was issued on the basis of price, the Cost Accounting Standards do not apply. We don't know that. We have to sit down with Electric Boat and make that determination.

When you say we have had a year to ferret this out, we applied for this exemption back in December, as you say, really back in May. Very honestly, we thought such a de minimus part of our business is defense oriented that the waiver would be granted. When we see now that it is not, naturally, we will do whatever is necessary to, No. 1, make good on the orders we have received, comply on those orders that we have received, and to do whatever is necessary working with Electric Boat, with the Navy, with the Defense Department, with your committee, or any other person that is involved, and we are going to comply with the regulations as we always have.

Senator PROXMIRE. Let me see whether I can clear up this matter with some straightforward questions.

First, United States Steel has now signed formal contracts on the items in question. Does each of the five contracts contain the Cost Accounting Standards clause?

Mr. RODERICK. Each contract we have been asked to sign, we have signed up to this point or accepted—we don't really sign them, we accept them—but we have made them subject to the granting of the waiver.

Since we have been denied the waiver I don't believe there have been any contracts that have been accepted subsequent to that date. We have several pending, Senator, and there is no doubt on those pending ones, two very major ones dealing with the flasks, the Cost Accounting Standards will apply and we will accept that order saying that we will comply, but we can't accept the order until we finalize the specifications. That is all that is holding it up.

Senator PROXMIRE. So I have your unequivocal statement that the purchase orders consummated will contain the Cost Accounting Standards clause?

Mr. RODERICK. I would say no question about it, where they are applicable.

Senator PROXMIRE. In a sense these are all noncompetitive procurements. But has United States Steel provided certified price and costing data required by the Truth-in-Negotiations Act?

Mr. RODERICK. Anywhere where we would be required to furnish the cost data with their negotiated bids we naturally would supply that cost information. We would have no reason not to. We have in the past. For many, many years we have supplied data on any contract requiring the cost information.

Senator PROXMIRE. Then I have your firm, unequivocal agreement that you have done so in the past, that you will do so this time, and that you will do so in the future procurements of this kind?

Mr. RODERICK. On any negotiated contract, no question about it, Senator, where required to do so.

Senator PROXMIRE. Is it your position that you can accept the current Cost Accounting Standards for air flask work done at your Christy Park plant?

Mr. RODERICK. Yes. We think that that is no problem. We have worked very closely with the Cost Accounting Standards Board and we have worked with the Navy audit people in Pittsburgh and we feel that that can be worked out and would be a very satisfactory solution for all involved.

Senator PROXMIRE. Lastly, is it your position that you will accept the current Cost Accounting Standards for the HY–80 steelplate work done at your Homestead plant?

Mr. RODERICK. Yes, we think we can work that out without major problems.

Senator PROXMIRE. Would you give the same assurances in sworn testimony at some future date?

Mr. RODERICK. If you desire us to do so, Senator, why, we will be very happy to. Any statement we make, obviously, will be equally truthful under oath or not under oath.

Senator PROXMIRE. Thank you.

Now, prior to your meetings earlier this month with the Cost Accounting Board, United States Steel had taken the position that Cost Accounting Standards were not compatible with your accounting system. After meeting with the board's staff, you agreed that you could implement the Standards.

In my opinion the Cost Accounting Standards Board has bent over backwards to explain its Standards and solicit comments from industry and make itself available to discuss specific problems. How can you explain the repeated refusals of United States Steel to comply with the Standards to the point of refusing to accept contracts and asking the Defense Department for support of your waiver request when you have not even taken the trouble to find out what was involved in complying with the Standards until now?

Mr. RODERICK. Senator, what we have done in the early stages of individual Standards, since we are not a defense contractor, since less than one-half of 1 percent of our business is concerned with defense contracting, we did not feel that we should take in that area an active part in developing those regulations and individual Standards. We felt that a waiver was an appropriate thing in those cases and we have not actively participated.

Now that our waiver has been denied you can be sure that on each individual Standard in the future we will take a very active part even though we again do not feel that we are overly qualified in this area in that we are not really a defense contractor. This is not really our cup of tea.

Senator PROXMIRE. Well, No. 1, I understand that the Cost Accounting Standards Board says they get good cooperation with other large firms with a small percentage of defense work and that United States Steel's lack of cooperation was conspicuous.

You see, I am not asking that you participate in the formulation of these Standards. What I am asking is that you, when asked to comply, find out whether it would be a fact that you would have to modify your accounting system as you allege before you seek a waiver or refusal.

Now, once you sat down for a few days, had your experts sit for a little while with the Cost Accounting Standards Board, you found it was not much of a problem. The question is—although it isn't a very big part of your business, nevertheless it is important to the defense of this country, and it involves millions of dollars—why couldn't you have determined that without having this long, long period of seeking a waiver and of keeping the Defense Department and the people who wanted to construct the submarines, in considerable doubt?

Mr. RODERICK. Senator, I really don't think we have kept them in very much doubt as far as the supply of the materials they needed. It certainly was not our intention nor will it be our intention in the future to ever obstruct in any way the development of these Standards and I am sure in retrospect if each party in this total proceeding were to have all the information on hand that we have today, I am sure that the problem could have been handled in a more expeditious manner.

We make note of your comment.

Senator PROXMIRE. One of the discrepancies which I find troublesome in this is that United States Steel says it accepts contracts with Cost Accounting Standards and sometimes it says the opposite. I will quote from your December 13 letter from your vice president, Mr. Haase, and I quote. He writes:

> * * * we have not accepted any contracts containing the cost accounting standards clause and the requirement to file cost accounting disclosure statements. We have consistently—

It says "consistently"—

> taken this same position with respect to requests for inclusion of the cost accounting standards clause and disclosure statement requirements in subcontracts placed by other customers under government prime contracts, as well as under prime contracts, placed by such as the Defense Construction Supply Center, Aberdeen Proving Grounds and others.

But the Defense Department waiver request cites a contract with your American Bridge Division containing the clause, and yesterday Mr. Schoenhaut told us he was informed by your people in Pittsburgh of numerous other prime and steel contracts containing the clause.

In your testimony you emphasize the firm's "refusal to contractually accept the CAS requirements"—whatever that means. Is this another case of having it both ways?

Mr. RODERICK. Not really, Senator. I think we deal with many, many orders. There is no question that I think in one or two cases in different

divisions that we did have an acceptance of the cost accounting requirements. Where it was accepted, I am sure they complied fully. But our position has been that really in the defense-oriented area that for Christy Park, for these flasks, for the HY–80, that it would be in the best interests of the parties if we were not required to comply with those Standards from an administrative point of view.

Our waiver was just very simple in that regard. We accepted orders all during this period but merely subject to the granting of the waiver as provided by the administrative procedures.

Senator PROXMIRE. Yesterday, we had testimony of Mr. Schoenhaut that in 1972 and 1973, you had some $77 million of contracts, with a Cost Accounting Standards clause in it.

Mr. RODERICK. That is right.

Senator PROXMIRE. That is a lot of money. It may not be a lot in view of your sales but it would still represent, it seems to me, a position which would directly contradict your statement, the statement of Mr. Haase, that United States Steel has consistently, I just quoted that, has consistently taken the same position with respect to not including Cost Accounting Standards clauses.

Mr. RODERICK. That particular contract, Senator, that made up the preponderance of the $77 million, was a bomb contract, as you know, both the Berwick plant and Christy Park. It was specifically a bomb contract.

What we did at that time and during that period of time, there were only one or two Standards that existed under the Cost Accounting Standards Board. They were Standards that gave us no problem at that point, where we thought that our system was compatible with those Standards and we really had no problem in complying at that point. It was the later Standards that we became concerned that maybe they would be inconsistent or were inconsistent with our standard cost system and we in effect changed our position to one that we sought a waiver ultimately on in 1974, as the regulations changed, too, the threshold requirements and so forth.

Senator PROXMIRE. I can see why you are the president of one of the biggest corporations in the country. You are an extraordinarily skilled person and your responses are very impressive. But it comes right down to the fact that Mr. Haase was just plain wrong. That statement was in error.

Mr. RODERICK. He said we have never accepted them, in that statement. That is not accurate and I would agree with your point.

Senator PROXMIRE. That is what he said. "We have not accepted any contracts containing * * *," and we just pointed to the $77 million contract.

Mr. RODERICK. I would have no quarrel with your bringing that to our attention.

Senator PROXMIRE. To your knowledge have you or any other officials of United States Steel received any encouragement or indication of support for your waiver request from the Defense Department, Dod?

Mr. RODERICK. No; actually, Senator, when we applied for this, all of our contacts, I think without exception were just back to Electric Boat. In other words, we applied to Electric Boat. From there they

processed it with the Navy, the Defense Department, and we really didn't even see the submission until after the fact.

Senator PROXMIRE. Then let me ask you about this: were you ever contacted personally or to your knowledge was any other senior official of United States Steel contacted by any official of the Navy or Department of Defense in an effort to obtain your agreement to comply with these Standards before the waiver was submitted to the Board on July 14?

Mr. RODERICK. Senator, I can only again speak for myself in my role at that time, which was chairman of the finance committee; the answer is no.

Senator PROXMIRE. Let me ask the gentlemen with you who have been intimately involved with it.

Mr. RODERICK. I would let them answer for themselves.

Senator PROXMIRE. Fine.

Mr. Smith?

Mr. SMITH. The only call I am aware of after we submitted the request for waiver was a call from some admiral, I don't recall his name. It didn't come to me and I heard of it.

Senator PROXMIRE. It wasn't Rickover was it? [Laughter.]

Mr. SMITH. No, sir.

Senator PROXMIRE. You would recall that?

Mr. SMITH. I would recall that. Asking Mr. Haase for a further explanation of the letter of December 14, that is the only——

Senator PROXMIRE. Further explanation was all that was requested.

Mr. SMITH. Yes.

Senator PROXMIRE. Mr. Watts?

Mr. WATTS. I am aware of no such requests or contacts personally.

Senator PROXMIRE. That doesn't speak well for the Defense Department in my view. You requested a waiver, and it would seem to me they ought to really go to bat and find out whether or not you could justify it. They should find out whether there was merit or no merit to it. They should explain why you should comply. I think it is an indication—perhaps, the most spectacular indication we have had yet in these hearings—of the failure of the Defense Department to comply with the law, with the act.

Mr. Roderick, have you contacted any members of the CASB, its staff or officials of the Defense Department prior to the meetings of this August, with a view toward examining how Cost Accounting Standards might affect your operation?

Mr. RODERICK. Again, I can speak for myself, Senator, and I would say that I did not. I have not talked to any of the individual members. Again, once our request for waiver was filed.

I will again let Mr. Smith answer for himself.

Senator PROXMIRE. Mr. Smith?

Mr. SMITH. The only contact that I recall having had with the Standards Board was a phonecall with Mr. Schoenhaut, I believe in 1971 or 1972, relative to the Standard Cost Standard that was being promulgated.

Senator PROXMIRE. Did you initiate that call or did he?

Mr. SMITH. I may have as a result of a letter from Mr. Schoenhaut to Mr. Speer I believe it was at that time.

Senator PROXMIRE. Mr. Watts?

Mr. WATTS. I again am aware of no contacts with them. There may have been contacts by——

Senator PROXMIRE. Gentlemen, here is the problem. After all, it is very important to the defense of this country that we get the best product we can at the lowest possible cost. United States Steel was in the best position to do it. You are a superlative firm, you have been a low cost and reliable supplier. You asked, as you say, you are anxious to sell to the Defense Department. But rather than take the initiative to find out how you could comply and whether the Cost Accounting Standards required were something that would be expensive and costly and inefficient, you simply requested a waiver. It is hard for me to understand why you would have this kind of weak and unenthusiastic interest in providing the steel to defend our country, if necessary.

Mr. RODERICK. Well, we have never, let's say, lacked an interest in supplying the steel for the defense requirements of the country, Senator.

Senator PROXMIRE. But if the standards requirements were an obstacle in the way of it, I don't understand why you didn't make an effort to find out how you could comply with them efficiently. Certainly, if you were selling to some other customer, to General Motors, and they had some requirements that seemed to be in conflict with what you had done in the past, I am sure you would put a top man to work right away to see how you could meet their requirements.

Mr. RODERICK. I would say, Senator, that General Motors may be more than one-half of 1 percent of our total business. So you may be right. [Laughter.]

Senator PROXMIRE. Well. I don't want to be unfair to you, Mr. Roderick, but I think you would agree that providing for the defense of our country is more important than providing for even General Motors. While the dollars may not be as big, the importance of providing for the defense, I am sure, is far more important to you as a patriotic American.

Mr. RODERICK. We have no quarrel with that at all and we have never stopped supplying that requirement.

Senator PROXMIRE. You never stopped but the point is you have never taken the initiative. You have never really forcefully tried to do your best to meet the requirements of law and to comply as efficiently and as quickly as you can.

Mr. RODERICK. We felt, Senator, as we indicated in our opening remarks, that really the Cost Accounting Standards, since it is one-half of 1 percent of our business, there is much talk of a 5-percent corridor exemption, but we felt in our case as not being a defense contractor, in our view, that the best thing for all parties was merely to grant a waiver and we would continue to supply the steel as we have in the past.

Senator PROXMIRE. So you sat there without a contract since May 1974, as I understand it, which was the beginning of your request for waiver, and without a contract for some 14 months——

Mr. RODERICK. No, sir. We were not without a contract. We accepted all those contracts subject to the granting of waiver. It has not been granted. We still have a contract. We are going to be required to comply.

Senator PROXMIRE. You didn't sign it.

Mr. RODERICK. But we will comply. So we have not in any way turned business away. We have not refused or hesitated to solicit business. So this thing has not been an obstacle in my opinion to the total defense effort.

Senator PROXMIRE. Can you give us any information on your company's plans regarding 19 contracts with General Dynamics, which Mr. Schoenhaut mentioned yesterday? There are the steel plate contracts aggregating $18.4 million, which have been contingent on a waiver of the Cost Accounting Standards in the wake of the Standards Board. In the wake of last week's agreement are you planning to withdraw the waiver contingency?

Mr. RODERICK. We will have no option whatever. The bulk of those orders have been filled, the steel delivered. They are probably in place in certain submarines. Where we have to furnish the data there is no question we will furnish it.

Senator PROXMIRE. So you will agree to abide by the Cost Accounting Standards clause in that case?

Mr. RODERICK. No question about it.

Senator PROXMIRE. You have taken strong issue with my statement that U.S. Steel was holding steel shipments as hostage in return for waiver of Cost Accounting Standards.

Mr. RODERICK. Yes; we felt that was a poor choice of language, Senator.

Senator PROXMIRE. All right, well, I think it might have been an accurate choice. At the time I was in possession of the waiver request from the Department of Defense which strongly implies that some shipments had been curtailed or halted. Subsequently, your corporation released a statement that said U.S. Steel was currently making deliveries of the steel. Now this is a rather coy phrase. Can you tell me unequivocally that none of the shipments of the steel products sought under the Electric Boat orders were curtailed, interrupted, delayed, terminated, reduced or withheld during the period from May 1974 up to the present?

Mr. RODERICK. I would say categorically we have not withheld any deliveries or delayed in any way the processing of any orders in our possession. Absolutely, we have not.

Senator PROXMIRE. Now let me read the DoD request. It says deliveries under this purchase order were originally scheduled to commence December 1974. Although the plate was put into production, deliveries were not commenced until March 1975. However, all remaining steel plate for the lead submarine has now been shipped. The purchase order for the SSN–688 class covers the full quantity of plate needed for the 11 submarines covered by the prime contract. It is understood that the plate for 1½ ship sets has been fabricated and delivered although the purchase order calls for deliveries of significant quantities every 3 to 4 months with completion schedules for November 1977. Electric Boat does not know whether U.S. Steel will resume deliveries.

Mr. RODERICK. I would recommend, Senator, that since the Defense Department has made that statement, that you have to ask them to explain it.

We will be happy to file with your committee—we have records here that clearly show that we have made uninterrupted shipments of

HY–80 steel each month this year, each month last year. If there would be any delay it would be a production bottleneck of some de minimus portion of the order that occurs in the normal course of business. We have continued to deliver. We have never stopped delivering. We will gladly file with your committee the exact status of each order that we have, the deliveries that we have made under each order that we have, and I am sure when you see that you will be completely satisfied that we have not withheld delivery and then I think you will have to ask someone in the Defense Department for their explanation of that statement. It is not an accurate statement in our opinion.

Senator PROXMIRE. Well, yesterday the Defense Department testified that they had been informed by the Navy, which was in a position to know, they felt, that deliveries had been delayed, had been late, had been held up.

You are saying this morning that that testimony is in error, is that correct?

Mr. RODERICK. Yes, sir. I think that indications were that they were held up because of this cost accounting. I am saying this——

Senator PROXMIRE. No, no, wait a minute. Let me make these two separate. It is hard to attribute motivation. I just want to know whether these were held up.

Mr. RODERICK. No.

Senator PROXMIRE. They were not held up?

Mr. RODERICK. Let me again say this and I say it categorically, that there was no effort at any time either in our Homestead works or Gary works, to delay any shipments to the Navy of HY–80 plate or HY–100 plate other than a delay that would be caused by, let's say, factors beyond our control in the production cycle or something of that nature.

Senator PROXMIRE. Were there factors beyond your control that caused delay in these cases?

Mr. RODERICK. We would have to review each case, Senator. I would say it would be normal where you have an order for literally thousands of individual plates that maybe on 2 percent of them or 5 percent of them you may deliver late for one reason or another. Sometimes customer changes and specifications, sometimes you get a bad heat in your production facilities and you have to rerun that heat. Those things are perfectly normal.

But I would say generally speaking, and I went out to Christy Park to assure myself personally this week, that we were not going to run late on these critical applications of the flasks, for example, and I am completely satisfied that the first requirement, as I recall, is in February 1976 for one set of these flasks. It is our intention to deliver three of them this year.

So we are not trying to—keep in mind we are dealing with a customer. We are not trying to withhold steel or delay shipments. We are trying to take an order and deliver that order as quickly and as expeditiously as we possibly can.

Senator PROXMIRE. It was the customer that made the observation that the steel was delayed. Now will you do this for the record? Will you provide in detail the schedule of shipments to Electric Boat and the actual shipments made by month?

Mr. RODERICK. In other words, the promised date and the date of actual delivery?

Senator PROXMIRE. That's right, and the delivery.

Mr. RODERICK. I would be happy to.

Senator PROXMIRE. And any changes in schedule that may have taken place in that period.

Mr. RODERICK. Yes; I would be happy to do that. (See exhibit 17 at p. 197.)

Senator PROXMIRE. Now you have been shipping all these products to Electric Boat and other prime contractors without a contract. How are you being paid?

Mr. RODERICK. To my knowledge we are being paid based on the terms of our order acceptance which in our standard terms is really 30 days, and to my knowledge we are being paid on time in compliance with our acceptance.

Senator PROXMIRE. Don't you have to have a firm contract to be paid by the Federal Government or one of its subcontractors?

Mr. RODERICK. I can't answer that. You would have to talk to one of the Government lawyers on that, Senator.

Senator PROXMIRE. At any rate you are not providing steel on the cuff?

Mr. RODERICK. That is not our custom and I am sure we are not doing it here.

Senator PROXMIRE. Mr. Watts, are you a company lawyer qualified to tell us about that?

Mr. WATTS. I do not believe that I am qualified—you are asking do we have to have a firm fixed-price contract?

Senator PROXMIRE. I am asking, do you have to have a contract that is signed to be paid by the Federal Government or by one of the subcontractors?

Mr. WATTS. If the contract is directly with the Federal Government, yes, we need to have a signed contract.

Senator PROXMIRE. You don't have that and you have been paid apparently, is this a violation of the law?

Mr. WATTS. What we are talking about here, I believe, are contracts not directly with the Federal Government but contracts or orders entered by subcontractors or orders that are entered by a prime contractor with the Federal Government, so that the orders to us are not——

Senator PROXMIRE. So it is your understanding that if the Federal Government makes a contract with a prime contractor and pays that prime contractor probably in progress payments, then the prime contractor can turn around and make payments to a subcontractor without a contract, using the Federal money to make the payments?

Mr. WATTS. I am not qualified to answer that question.

Mr. RODERICK. I think that would take someone in the Government to answer that.

We should clarify, Senator, when we say we are working without a contract, in effect it is my understanding that when we get an order from Electric Boat, that in effect they ask us to produce and supply certain materials. We acknowledge that in our regular acknowledgement form and that, in effect, is a contract as far as we are concerned.

So when you say "without a contract," we feel that we have contracts in each of these instances. They were subject to the granting of the waiver. We also have a standard clause that indicates that all of our acceptances will comply with all regulations of the Government.

Now the regulations permitted us to ask for a waiver. Our waiver was denied, so therefore all of these contracts are in place, and as far as we are concerned valid contracts. So I—when you say you have no contract, I don't quite understand what you mean. We feel we have a contract. We feel we have some completed ones. We feel we have some in process. We feel we are in the process of negotiating some additional ones.

Senator PROXMIRE. Now, if there have been no delays, curtailments, reductions or interruptions in provision of the required product, then why did United States Steel find it necessary to send Electric Boat the telegram of August 7 (exhibit 14), assuring them there would be no delays in meeting delivery schedules?

Mr. RODERICK. Well, because we were asked to give that assurance and we were happy to do so. There had not been any delay on our part and we were assuring them of that.

Senator PROXMIRE. You were asked to give that assurance. Was that in Electric Boat's August 1 telegram?

Mr. RODERICK. I would have to look at that. In addition to telegrams, we have had phone conversations with them. What they were specifically concerned about are these two rather major pending orders for these air flasks, of which they want the first complete set delivered by February 1976.

As I indicated, even though we do not have the order yet because the specifications have not been finalized, we have rolled the steel on the cuff. It has been delivered to Christy Park. We are waiting to fabricate, and we were merely again assuring them that even though we have not been able to finalize those orders, there will be no delay in meeting their delivery requirements, which in that case is February 1976, and our objective is to deliver in the fourth quarter.

Senator PROXMIRE. Why did it take 6 days to respond to Electric Boat's telegram when all it requested was assurances that production was continuing? Why couldn't that have been done immediately?

Mr. RODERICK. I think that Electric Boat's communication was sent out on the 1st. I forgot whether it was a Friday or not. I think maybe it was.

I believe it came into our hands—it was sent to our chief executive officer, Ed Speer. When he received it, I think it was probably the following Monday. We immediately started to check to see if there had been any delays or any problems and as soon as we clarified that there were no delays on our part nor intended on our part, we issued that assurance.

So I think we acted rather expeditiously.

Senator PROXMIRE. Your statement was made available to me, and I studied it, and Dr. Bennett's waiver request also. Regarding your contention that United States Steel is not the sole source for the products in question—toroid rings, HY-80 steelplate, and HY-80—it is my understanding that United States Steel is the de facto sole source for air flasks and HY-80 steelplate in view of the limited capacity and inadequate fabricating facilities by other manufacturers.

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Can you give me any strong reason for believing that your proposed alternatives are in truth not costly or unrealistic?

Mr. RODERICK. I don't think they are unrealistic at all. On HY–80 I would assume that other major producers could produce this material. Several people have produced it and gone out of business, but they have the capability. So I think there could be multiple sources, Senator, for HY–80. I have no reservation on that.

On the air flask, Senator, we have to be realistic. At the moment I don't think there are any other contractors that we are aware of that could meet the immediate delivery requirements of the Navy for either the Trident series of the SSN–688 other than Christy Park. But what we do feel very strongly is that—we believe in competition. We don't like to get into a sole source position.

I was just reading in People's magazine a little writeup on yourself, Senator, that you indicate that when you start swimming laps and somebody is swimming alongside of you, you swim a little harder. Well, we do the same thing in business.

We thrive on competition and we don't like to be sole source and what we say is we encourage the Defense Department to create other sources of supply because long term the best interests of the Defense Department will be served when there is active competition rather than sole source suppliers. That is really our position.

Senator PROXMIRE. Well, I certainly agree and I think everybody who is interested in the public interest would agree wholeheartedly that military procurements should be held in such a way as to develop competition and encourage the maximum competition. I have criticized the Department of Defense again and again on the fact that only 10 percent of defense procurement in the past several years has been by advertised competitive bid.

But in view of the price-fixing lawsuit now in progress, what confidences can we have in the integrity of the competitive bidding on steel products?

Mr. RODERICK. Well, Senator, again I think my comments addressed that question. I think you are undoubtedly referring to the HY–80. We have, of course, categorically denied that accusation. It is purely an allegation. It has been thoroughly examined one time by the FTC and they found no foundation for the allegation.

They have again reopened it. These are unproven charges, they are purely allegations and to our best knowledge there is absolutely no foundation for those charges whatever.

Senator PROXMIRE. Of course, there is a strong difference of opinion on this. The Federal Government felt strongly enough about this to take you to court. The fact is that United States Steel does produce the overwhelming amount of HY–80 steel, as I understand it.

You have a commanding position. If you make that competitive, then the bulk of awards would go at your price to United States Steel without requiring you to submit under the Truth-in-Negotiations Act the cost and pricing data which would put us in a position to know whether we were getting the product at a fair price and reasonable price.

Mr. RODERICK. All of our prices are fair and reasonable, Senator.

Senator PROXMIRE. I think it is also fair to point out that United States Steel has been a major defense supplier in the past and might

well be again under conditions like those of the Vietnam War. For example, as recently as fiscal year 1973 United States Steel was one of the major producers of bomb bodies for demolition bombs, doing $64 million worth of business in that year alone.

Can you say what part of the reduction of your defense business is attributable to the end of hostilities in Southeast Asia?

Mr. RODERICK. I would say the bomb business has completely gone, Senator. I believe it finalized in 1974. There might have been $100,000 or something coming into 1975. That really was the preponderance of the business.

So in those years where we were at Christy Park and Berwick maybe going at the rate of $40 or $50 million a year, I will say that the defense-oriented business now is more typically in the range of—at Christy Park where we are talking about these bombs—would be probably closer to something along $3 or $4 million a year, a more typical situation.

So in answer to your question, the preponderance of the business we have had in recent years has now disappeared and, in fact, the bomb lines have been removed or are in the process of being removed.

Senator PROXMIRE. Can you tell us the total amount of United States Steel's defense business, prime contract and subcontract, for calendar year 1975? It is lacking in your testimony.

Mr. RODERICK. We certainly can supply that information. I don't believe we have it with us.

Senator PROXMIRE. 1974, excuse me, last year.

Mr. RODERICK. We can supply that plus any that we have in 1975 and we will put that in the record. (See exhibit 18 at p. 198.)

Senator PROXMIRE. Can you give me an estimate of what that would be?

Mr. RODERICK. I don't want to be misleading in any way, Senator, but just off the top of my head I would say probably in 1974, oh, somewhere in the neighborhood of $5 to $10 million, and I would assume that maybe this year somewhere in that same category.

Senator PROXMIRE. You are talking about prime and subcontracts?

Mr. RODERICK. Yes, for the defense effort you refer to or are you talking about total Government contracts?

Senator PROXMIRE. Well, for the defense effort.

Mr. RODERICK. I would say for the defense effort, again off the top of my head, that is the range.

Now, what we will do and be very happy to do, Senator, we will give you the exact amount of the invoicing to——

Senator PROXMIRE. I think you would want to look at that again, because that $4 or $5 million seems to conflict with testimony that we have on what you are supplying to not only Electric Boat, but also to General Dynamics and——

Mr. RODERICK. General Dynamics is Electric Boat, Senator. They are the same.

Senator PROXMIRE. I had another General Dynamics contract in mind. It could be multiyear, of course.

Mr. RODERICK. I would again think those numbers are approximately correct. As I recall, I said $5 to $10 million, but we will glady furnish that data, Senator. There is no problem there at all. We will send that to your office.

Senator PROXMIRE. I have one final question now and I am sure you will want to address it because I think you are well qualified to do so.

Your reaction, Mr. Roderick, to the Defense Department's charges of a lack of cooperation is interesting.

I have had compiled a chronology of problems with United States Steel, going back to 1951. It runs over three pages of highlights and includes implications and verifications of collusion in bidding and steel price setting, alleged violations of consent decrees, refusals to provide cost and price data on contracts where it was required.

Not all of these charges have been verified, as you say, partly, I think, because of poor followup by the Defense Department and other Government agencies. But it is hard to escape the conclusion that this most recent episode is anything more than another chapter in the effort to escape Government regulations and statutes designed to protect the public purchases.

Can you give us another explanation for this consistent theme in Government's dealings with United States Steel or are you the victims of a conspiracy?

Mr. RODERICK. I can't say there is any conspiracy at all, Senator. There certainly is not on our part. We feel and we must be realistic, that anybody you are doing business with, you are always going to develop misunderstandings as well as understandings.

I would say that our effort in the defense area has been basically, as far as we are concerned, always one of cooperation, to furnish the steels that are needed or the materials that are needed for the defense effort.

I think with the long history of United States Steel, for example, the HY-80, the very steel that we are being criticized for, was developed by United States Steel Corporation for the Navy. We specifically developed that, the HY-100 was developed, and we are developing others such as HY-130. So we have constantly worked with the defense effort. We have worked with them on the bomb lines, production of bombs. We have worked with them on the submarine program.

We have had research contracts. We currently have research contracts with the Army, Navy, Air Force. We are improving the steels that they are using, and the applicability of those steels to specific applications.

So I think that, again, although you may have three pages of—a part of which—a large part of which are unfounded allegations in my opinion, I am sure I could create a book that would be listing many cases of extreme cooperation between the defense effort of this country and the people of the United States Steel.

Senator PROXMIRE. Well, now, in fairness to you and to United States Steel, Mr. Roderick, I will be happy to make this chronology available to you and you can comment for the record in any detail you wish——

Mr. RODERICK. I would appreciate that.

Senator PROXMIRE [continuing]. To rebut these charges. This will be made available also to the press for their information.

(See exhibit 19 at p. 213.)

Senator PROXMIRE. Mr. Roderick, Mr. Smith, Mr. Watts, I thank you very much for your testimony. You have been responsive and strong and helpful witnesses this morning. Although there is an area of very,

very strong disagreement, nevertheless, I think you have been a very helpful witness, Mr. Roderick.

Thank you very much.

Mr. RODERICK. Thank you very much.

Senator PROXMIRE. Our next witness is Admiral Rickover, Deputy Director for Nuclear Propulsion, Naval Sea Systems Command, and Director of the Division of Naval Reactors, U.S. Energy and Development Administration.

We are all aware of Admiral Rickover's contributions to this country as the father of the nuclear Navy, as an outstanding engineer, administrator, authority on education, and intellectual in the true sense of the word. It was Admiral Rickover who first highlighted the need for Cost Accounting Standards in defense contracting. Largely at his instigation legislation was introduced and subsequently enacted establishing the Cost Accounting Standards Board, and of course it is the application and effectiveness of that law which is the subject of these hearings now.

Admiral Rickover has made great contributions in maintaining a strong national defense. At the same time we should be just as aware of his efforts to protect the taxpayers' interests. I know of no one else in the Defense Department who believes as strongly as he does that Government officials have the responsibility to spend taxpayers' money as if it were their own.

Admiral, your philosophy does not always find favor with industry or with your superiors in the Government, but it does with the American people and I hope that you will keep it up.

Through the years Congress has called on Admiral Rickover time and time again to share with us his insight into many of the problems facing Government. In over a half century's service to the nation, he has accumulated experience in dealing with contractors that, to my knowledge, is unmatched anywhere else in Government.

In these hearings we are focusing on the problems of enforcing Cost Accounting Standards. Admiral Rickover has been in a unique position to observe defense procurement on a firsthand basis day to day during his 25-year tenure as head of the Naval Nuclear Propulsion program and prior to that as head of the Bureau of Ships Electrical Section during World War II.

Admiral, the rules of the Joint Committee require that each witness limit his spoken testimony to 10 minutes. After that we would like to obtain your views about the United States Steel situation and about the broader issues of assuring compliance with Cost Accounting Standards.

You may proceed, sir.

STATEMENT OF ADM. H. G. RICKOVER, DEPUTY DIRECTOR FOR NUCLEAR PROPULSION, NAVAL SEA SYSTEMS COMMAND, AND DIRECTOR, DIVISION OF NAVAL REACTORS, U.S. ENERGY RESEARCH AND DEVELOPMENT ADMINISTRATION

Admiral RICKOVER. Thank you Mr. Chairman, for your very kind words.

I am about to read a statement before the committee, but before I begin, I would like to say that the Department of Defense concurs in my statement—I am sorry, I should say "approved."

I welcome this opportunity to appear before you in connection with Cost Accounting Standards and their application to Government procurements. The Cost Accounting Standards Board recently turned down a request submitted by the Department of Defense on behalf of the United States Steel Corporation for a waiver of Cost Accounting Standards. The Board's action has focused attention on the criteria by which waivers are granted to procurement laws and regulations.

I understand that within the past week United States Steel has stated in writing that it can and will comply with Cost Accounting Standards whenever these Standards are applicable to their contracts, in accordance with the law and the regulations of the board. Hopefully this action by United States Steel will prompt other contractors, who have been resisting the Standards, to accept them.

The problem is not limited to the United States Steel situation. Ingersoll-Rand, a supplier of submarine pumps, and the Ladish Company, a forging vendor, are also seeking waivers under threat of not accepting vital defense orders. Since these two contractors are in a sole-source position, they have the ability to disrupt Navy ship construction by making acceptance of defense work conditional upon waiver of Cost Accounting Standards.

There are other, more subtle ways of frustrating the law, and the committee should be aware of them. For example, United States Steel's agreement with the Board is carefully worded to emphasize United States Steel's willingness to comply when such Standards are applicable to their contracts. That word "applicable" is a very important word, Mr. Chairman, as I will demonstrate.

Some defense contractors contend they will comply with all laws and regulations, and then try to exploit loopholes in the applicability of these laws and regulations to argue that, in their case, the law does not apply. Moreover, it is not uncommon for Government officials to endorse such liberal interpretations with the result that, in practical terms, the contractor succeeds in circumventing the law.

Mr. Chairman, the clause I am about to read is contained, to the best of my knowledge, in all contracts with the Government accepted by United States Steel and possibly all the company's other contracts as well.

Paragraph 11 from the United States Steel standard order acknowledgement form reads as follows:

> No terms or conditions, other than those stated herein, and no agreement or understanding, oral or written, in any way purporting to modify these terms and conditions shall be binding on Seller [that is United States Steel] unless hereafter made in writing and signed by its authorized representative. Acceptance of the products sold hereunder shall constitute assent to these conditions and Seller hereby objects to and rejects any and all additional or different terms proposed by Buyer, whether contained in Buyer's purchasing or shipping release forms or elsewhere. All proposals, negotiations, and representations, if any, made prior and with reference hereto are merged herein.

The significance of this clause results from the fact that United States Steel does not sign contracts, but simply "accepts" them and only then under the terms of the disclaimer I have just read. Apparently, no formal contract is signed by both United States Steel and its customers. Instead, the company issues an acceptance form, attaches its own terms and conditions, and proceeds with performance. Therefore, it appears that United States Steel agrees only to the terms

of its own acceptance, and not to the terms of contracts issued to them.

As a result, I doubt that any contracts with United States Steel are legally enforceable since the parties never agree on contract terms. I hope you appreciate what I am saying, Mr. Chairman, because I understand you have received unconditional agreement from United States Steel regarding compliance with Cost Accounting Standards. I therefore recommend you ask United States Steel whether they will sign contracts which include a Cost Accounting Standards clause and which are binding or whether their promise to comply is in fact negated by the disclaimer I have just read.

Senator PROXMIRE. An excellent suggestion and we will certainly follow up on that. (See correspondence beginning on p. 202.)

Admiral RICKOVER. Thank you, sir. I will now continue.

Many contractors have used these tactics to evade the Truth-in-Negotiations Act. This act was passed more than a decade ago. It requires contractors to provide cost or pricing data in circumstances where there is little or no competition, and the Government needs such information in order to negotiate a fair and reasonable contract price.

Some contractors refuse to comply with the Truth-in-Negotiations Act. In some industries virtually all companies successfully defy its requirements. Computer manufacturers, steel and nickel suppliers, forging companies, tire, ball bearing manufacturers, and communications industries are among those who have not complied.

In terms of Truth-in-Negotiations, contractors have argued that there is adequate competition where only a few bids were submitted and these were widely disparate. Conversely, they will claim that "competition" exists even in cases where contractors have established a pattern of submitting identical bids.

This has been happening since the early 1960's with Navy procurements involving United States Steel. Yet two audits conducted by the General Accounting Office, first in 1965 and later in 1972, both indicated that adequate competition did not exist and that cost and pricing data was required.

United States Steel would not provide the data, however, and the Department of Defense refused to get involved. This left the Navy to solve its own problems with noncompliant contractors.

At this point I would like to give you the definition of the word "competition" as interpreted by United States Steel. The following statement was made by the then chairman of the board of United States Steel, Roger Blough, on August 12, 1957, in testimony before the Kefauver Subcommittee on Antitrust and Monopoly. I will refer to these hearings later on.

> My concept is that a price that matches another price is a competitive price. If you don't choose to accept that concept, then of course you don't accept it. In the steel industry we know it is so . . . I say the buyer has more choice when the other fellow's price matches our price.

That is a verbatim statement made by the chairman of the board of United States Steel in defining the term "competition" as understood by United States Steel and others in the steel industry. I think this interpretation is worthy of your attention today.

Senator PROXMIRE. In other words, where the buyer has no option on price, where he has no choice, where there is no lower or higher bidder, they say that is real competition.

Admiral RICKOVER. That is correct. That is true competition in accordance with the United States Steel lexicon. They must have made up a dictionary of their own.

Now, let me give you an example of the kind of competition that goes on in the steel industry.

In December 1969 and January 1970 I reported to my superiors that in the case of HY–80 steel plate, bids were received from United States Steel and Lukens such that when freight costs from the steel plants to the shipyard were added to quoted prices, the prices were identical. It seems to me that identical pricing such as this is more an example of cooperation than of competition.

In another case, involving high-tensile steel, steel companies quoted identical prices before transportation costs were added. The customer then purchased the steel on a sole-source basis from the nearest supplier without soliciting other bids. Again, it is hard for me to view identical prices as competition.

I am giving you examples of real life practice in contrast to the kind of competition described by the spokesmen for United States Steel.

Contractors have also insisted that the Truth-in-Negotiations Act does not apply to their contracts because of the exemption provided for items involving standard catalog prices, even though the Government is the only customer.

I am sure you understand the catalog concept. Once a price is published in the catalog, some contractors say this is the competitive price. You are supposed to conclude that many people are buying the item. But some contractors take an item which the Government alone buys and include it in their catalogs and say: "Now we have competition." We call it competition, hence it is competition.

But it looks like a duck, it walks like a duck, it quacks like a duck, it is in competition. It is easy to publish a price in a catalog, and the fact that it appears there is no assurance the price is reasonable.

Another device for circumventing the law is illustrated by the situation several years ago when a shipbuilder purchased $3.4 million dollars of steel on a sole-source basis by issuing 1,200 individual purchase orders. In that way, no single order was greater than the $100,000 threshold which determines whether the contractor must submit cost or pricing data.

What it boils down to is this: Some contractors are willing to accept Government work for which they do not have to submit cost or pricing data, but refuse to accept Government work when the data is required. Many of these contractors go to virtually any length in order to stretch the requirements of the law so that it will not apply to their procurements.

Contractors are not solely to blame. Sometimes Government personnel try to avoid the problem of getting certified cost or pricing data from contractors who refuse to provide it. The limited number of requests for waivers of the requirements of the Truth-in-Negotiations Act indicates that some Government procurement people may be making questionable determinations that the law does not apply, rather than report problems of noncompliance to their superiors.

Even in the few cases where noncompliance is brought to the attention of higher authorities, there has been little success in obtaining the required cost breakdowns. In one case a subcontractor agreed to provide cost data only if he was given the order under risk-free, cost-type contract terms. Senior Government officials succumbed to these terms.

While the letter of the law was met, the spirit and content were not. In my opinion Congress did not intend that the Truth-in-Negotiations Act result in increases in the Government's risk.

The same potential for circumvention of the law for Truth-in-Negotiations also exist with Cost Accounting Standards. The law applies only to noncompetitive situations where the assurances of fair price provided by an open market do not exist.

The regulations which implement Cost Accounting Standards provide for other exemptions as well. In fact, the Standards do not apply to several entire categories of negotiated contracts. These categories include the procurement of commercial items sold in substantial quantities to the general public and for which catalog or market prices exist. Also, the Standards do not apply to the procurement of items for which prices are set by law or regulation, nor to certain contracts awarded under small business and labor surplus area programs.

If the exemptions are abused, it may become necessary to rescind them altogether. In the meantime, requests for waiver of the Standards must be carefully evaluated and those without merit refused. Procuring agencies must be more than just forwarding agents for contractors who demand waivers. Within 2 weeks after receipt of the United States Steel waiver request, the Cost Accounting Standards Board obtained United States Steel's agreement to "comply" with the Standards. I would like to add that the word "comply" is still in quotation marks. The question arises, why was the Defense Department unable to resolve the problem without referring it to the Board?

The point is that waivers and exemptions are just that—exceptions to the rule. This point must be clearly understood both by contractors and procurement officials, if Cost Accounting Standards and other procurement safeguards are to be effective.

There are constant pressures to relax criteria for waivers. In the case of Cost Accounting Standards, it has been suggested that waiver authority be granted to the Defense Department. In the case of the Truth-in-Negotiations Act, the Armed Services Procurement Regulations Committee is currently considering a proposal to delegate waiver authority from the Assistant Secretary level to the procurement activities. In my opinion, such delegations of authority would tend to undermine current safeguards.

When they are confronted by a supplier who refuses to comply with procurement regulations, some procuring agencies consider they have no recourse except to seek waivers. I believe there is recourse under the Defense Production Act in such cases. This act clearly recognizes the authority of the Government to direct contractors to perform defense work. Such directed orders obviously must include all other applicable provisions of law including Cost Accounting Standards and Truth-in-Negotiations.

I have the following recommendations to insure that laws enacted by Congress and the regulations which implement these laws are applied in accordance with congressional intent:

1. Requirements of laws and regulations should be waived only in extraordinary circumstances. Waivers should not be granted simply by virtue of a contractor's influence or economic clout, or because he has only a modest volume of Government business and finds application of the law inconvenient.

2. Procuring agencies, including the Department of Defense, should insure that their procedures for monitoring compliance with procurement regulations are strict enough to insure that the exemptions provided under the laws and regulations will not be abused. Emphasis should be placed on how exemptions already provided are interpreted and applied. The agencies should insure that procurement officials do not abuse exemptions provided by laws or regulations.

3. An independent agency, such as the General Accounting Office, should periodically perform an audit to insure that agency procedures for compliance with these laws and regulations are adequate and that the agencies are complying with their own procedures. The GAO should report its findings to Congress, and Congress should require procuring agencies to identify corrective action and a schedule for implementing such action.

4. Procuring agencies should use the Defense Production Act, if necessary, to obtain performance on defense orders. Sole-source contractors should not be allowed to exploit their position to avoid complying with procurement laws and regulations.

Mr. Chairman, the apparent resolution between United States Steel and the Cost Accounting Standards Board is encouraging. I hope it will be honored in good faith by United States Steel. However, the problem of obtaining compliance with the requirements of Cost Accounting Standards and other laws and regulations is still with us.

Some contractors are trying to have the requirements of the law waived. Based on my experience, I expect requests for waivers will continue. To discourage such requests and enforce procurement laws and regulations, procurement authorities must insure that the apparent success of the Board in the case of United States Steel is not subsequently negated by liberal interpretations of adequate competition, catalog or market prices, and so on.

The issue is the administration of these laws and regulations. Congress in exercising its oversight function should require that procuring agencies administer these laws and regulations equitably and that all contractors receive equal treatment, without regard to extraneous considerations such as influence or economic leverage exercised by the contractor.

Today, more than ever before, it is important that high officials and the institutions for which they are responsible set the moral tone for our people. Business permeates our lives. It depends, more than most activities, upon respect for law. Therefore, it is reckless of business leaders to take refuge in legal exemptions that may give them short-term profit but weaken the moral fiber of our society.

Law is no substitute for justice.

That is the end of my statement.

[Prepared statement of Admiral Rickover follows:]

(This statement reflects the views of the author and does not necessarily reflect the views of the Secretary of the Navy or the Department of the Navy.)

STATEMENT TO JOINT COMMITTEE ON DEFENSE PRODUCTION, CONGRESS OF THE UNITED STATES, CONCERNING "COST ACCOUNTING STANDARDS IN GOVERNMENT CONTRACTING"

(By Admiral H. G. Rickover, USN)

I welcome this opportunity to appear before you in connection with Cost Accounting Standards and their application to Government procurements. The Cost Accounting Standards Board recently turned down a request submitted by the Department of Defense on behalf of the United States Steel Corporation for a waiver of Cost Accounting Standards. The Board's action has focused attention on the criteria by which waivers are granted to procurement laws and regulations.

I understand that within the past week, U.S. Steel has stated in writing that it can and will comply with Cost Accounting Standards whenever these Standards are applicable to their contracts, in accordance with the law and the regulations of the Board. Hopefully, this action by U.S. Steel will prompt other contractors, who have been resisting the Standards, to accept them.

The problem is not limited to the U.S. Steel situation. Ingersoll-Rand, a supplier of submarine pumps, and the Ladish Company, a forging vendor, are also seeking waivers under threat of not accepting vital defense orders. Since these two contractors are in a sole source position, they have the ability to disrupt Navy ship construction, by making acceptance of defense work conditional upon waiver of cost accounting standards.

There are other, more subtle ways of frustrating the law, and the Committee should be aware of them. For example, U.S. Steel's agreement with the Board is carefully worded to emphasize U.S. Steel's willingness to comply when such standards are applicable to their contracts. Some defense contractors contend they will comply with all laws and regulations, and then try to exploit loopholes in the applicability of these laws and regulations to argue that, in their case, the law does not apply. Moreover, it is uncommon for Government officials to endorse such liberal interpretations with the result that, in practical terms, the contractor succeeds in circumventing the law.

Many contractors have used these tactics to evade the requirements of the Truth-in-Negotiations Act. This Act was passed more than a decade ago. It requires contractors to provide cost or pricing data in circumstances where there is little or no competition, and the Government needs such information in order to negotiate a fair and reasonable contract price.

Some contractors refuse to comply with the Truth-in-Negotiations Act. In some industries, virtually all companies successfully defy its requirements. Computer manufacturers, steel and nickel suppliers, forging companies, tire, ball bearing manufacturers, and communications industries are among those who do not comply.

In terms of Truth-in-Negotiations, contractors have argued that there is adequate competition where only a few bids were submitted and these were widely disparate. Conversely, they will claim that "competition" exists even in cases where contractors have established a pattern of submitting identical bids. This has been happening since the early 1960's with Navy procurements involving U.S. Steel. Yet, two audits conducted by the General Accounting Office, first in 1965, later in 1972, both indicated that adequate competition did not exist and that cost and pricing data was required. U.S. Steel would not provide the data, however, and the Department of Defense refused to get involved. This left the Navy to solve its own problems with non-compliant contractors.

Contractors have also insisted that the Truth-in-Negotiations Act does not apply to their contracts because of the exemption provided for items involving standard catalog prices, even though the Government is the only customer. It is easy to publish a price in a catalog, and the fact that it appears there is no assurance the price is reasonable.

Another device for circumventing the law is illustrated by the situation several years ago when a shipbuilder purchased $3.4 million of steel on a sole source basis by issuing 1,200 individual purchase orders. In that way, no single order was greater than the $100,000 threshold which determines whether the contractor must submit cost or pricing data.

What it boils down to is this: some contractors are willing to accept Government work for which they do not have to submit cost or pricing data, but refuse to accept Government work when the data is required. Many of these contractors

go to virtually any length in order to stretch the requirements of the law such that it will not apply to their procurements.

Contractors are not solely to blame. Sometimes, Government personnel try to avoid the problem of getting certified cost or pricing data from contractors who refuse to provide it. The limited number of requests for waivers of the requirements of the Truth-in-Negotiations Act indicates that some Government procurement people may be making questionable determinations that the law does not apply, rather than report problems of non-compliance to their superiors.

Even in the few cases where non-compliance is brought to the attention of higher authorities, there has been little success in obtaining the required cost breakdowns. In one case, a subcontractor agreed to provide cost data only if he was given the order under risk-free, cost-type contract terms. Senior Government officials succumbed to these terms. While the letter of the law was met, its spirit and content were not. In my opinion, Congress did not intend that the Truth-in-Negotiations Act result in increases in the Government's risk.

The same potential for circumvention of the law for Truth-in-Negotiations also exists with Cost Accounting Standards. The law applies only to non-competitive situations where the assurances of fair price provided by an open market do not exist. The regulations which implement Cost Accounting Standards provide for other exemptions as well. In fact, the standards do not apply to several entire categories of negotiated contracts. These categories include the procurement of commercial items sold in substantial quantities to the general public and for which catalog or market prices exist. Also, the Standards do not apply to the procurement of items for which prices are set by law or regulation, nor to certain contracts awarded under small business and labor surplus area programs.

If the exemptions are abused, it may become necessary to rescind them altogether. In the meantime, requests for waiver of the Standards must be carefully evaluated and those without merit refused. Procuring agencies must be more than just forwarding agents for contractors who demand waivers. Within two weeks after receipt of the U.S. Steel waiver request, the Cost Accounting Standards Board obtained U.S. Steel's agreement to comply with the Standards. The qustion arises—why was the Defense Department unable to resolve the problem without referring it to the Board?

The point is that waivers and exemptions are just that—exceptions to the rule. This point must be clearly understood both by contractors and procurement officials if Cost Accounting Standards and other procurement safeguards are to be effective.

There are constant pressures to relax criteria for waivers. In the case of Cost Accounting Standards, it has been suggested that waiver authority be granted to the Defense Department. In the case of the Truth-in-Negotiations Act, the Armed Services Procurement Regulation Committee is currently considering a proposal to delegate waiver authority from the Assistant Secretary level to the procurement activities. In my opinion, such delegations of authority would tend to undermine current safeguards.

When they are confronted by a supplier who refuses to comply with procurement regulations, some procuring agencies consider they have no recourse except to seek waivers. I believe there is recourse under the Defense Production Act in such cases. This Act clearly provides the authority for the Government to direct contractors to perform defense work. Such directed orders obviously must include all other applicable provisions of law including Cost Accounting Standards and Truth-in-Negotiations.

I have the following recommendations to insure that laws enacted by Congress and the regulations which implement these laws are applied in accordance with Congressional intent:

(1) Requirements of laws and regulations should be waived only in extraordinary circumstances. Waivers should not be granted simply by virtue of a contractor's influence or economic clout, or because he has only a modest volume of Government business and finds application of the law inconvenient.

(2) Procuring agencies, including the Department of Defense, should insure that their procedures for monitoring compliance with procurement regulations are strict enough to insure that the exemptions provided under the laws and regulations will not be abused. Emphasis should be placed on how exemptions already provided are interpreted and applied. The agencies should ensure that procurement officials do not abuse exemptions provided by laws or regulations.

(3) An independent agency, such as the General Accounting Office, should periodically perform an audit to insure that agency procedures for compliance

with these laws and regulations are adequate and that the agencies are complying with their own procedures. The GAO should report its findings to Congress, and Congress should require procuring agencies to identify corrective action and a schedule for implementing such action.

(4) Procuring agencies should use the Defense Production Act, if necessary, to obtain performance on defense orders. Sole source contractors should not be allowed to exploit their position to avoid complying with procurement laws and regulations.

Mr. Chairman, the apparent resolution between U.S. Steel and the Cost Accounting Standards Board is encouraging. I hope it will be honored in good faith by U.S. Steel. However, the problem of obtaining compliance with the requirements of Cost Accounting Standards and other laws and regulations is still with us. Some contractors are trying to have the requirements of the law waived. Based on my experience, I expect requests for waivers will continue. To discourage such requests and enforce procurement laws and regulations, procurement authorities must ensure that the apparent success of the board in the case of U.S. Steel is not subsequently negated by liberal interpretations of adequate competition, catalog or market prices, and so on.

The issue is the administration of these laws and regulations. Congress, in exercising its oversight function, should require that procuring agencies administer these laws and regulations equitably and that all contractors receive equal treatment, without regard to extraneous considerations such as influence or economic leverage exercise by the contractor.

Today, more than ever before, it is important that high officials and the institutions for which they are responsible set the moral tone for our people. Business permeates our lives. It depends, more than most activities, upon respect for law. Therefore, it is reckless of business leaders to take refuge in legal exemptions that may give them short term profit but weaken the moral fiber of our society. Law is no substitute for justice.

Senator PROXMIRE. Thank you very, very much, Admiral Rickover. You have made an excellent statement. Also for the fact that you have been able to get approval from the Defense Department for your statement.

Tell me a little bit about that. You said it was not concurrence, but approval. What is the difference?

Admiral RICKOVER. You mean about the terms of the United States Steel contracts?

Senator PROXMIRE. When you came up this morning, you said you were presenting the statement this morning and that it had gone through the Defense Department and they had approved it. First you said "concurrence" and then you said, no, it was "approval." It is interesting to us because I think the position of the Defense Department on this is very, very important.

Admiral RICKOVER. I cannot answer for the Defense Department. That word was carefully chosen and——

Senator PROXMIRE. To use the word "approval"?

Admiral RICKOVER. I received approval to make this statement.

Senator PROXMIRE. That you could make the statement. Does that mean they approve the substance of your statement?

Admiral RICKOVER. No, sir.

Senator PROXMIRE. I am glad to get that distinction.

Admiral RICKOVER. I hope you are not as naive as that, Mr. Chairman.

Senator PROXMIRE. Well, I may be pretty naive.

Admiral RICKOVER. Well, you appear naive, but I do not think you are. I think your looks are deceptive.

Senator PROXMIRE. I was hoping that this would have been quite a breakthrough if we could get the Defense Department to approve a statement like this. In any event——

Admiral RICKOVER. Let me illustrate how an agreement in principle such as that offered by United States Steel, may in actual practice turn out to be worthless. In 1972, a shipbuilder obtained United States Steel's agreement to furnish cost data under the Truth-in-Negotiations Act. Since the procurement was urgent, the shipbuilder placed the order before the cost data was audited. However, the shipbuilder sought to protect the Government's interest by providing in the contract with United States Steel that the contract price was the maximum and was to be negotiated downward based on audit of United States Steel's cost data.

Subsequently the shipbuilder received the audit report which showed that United States Steel's profit on the order was 39 percent. Further, the audit reported that over one-third of the costs were for material bought by one division of United States Steel from another division of United States Steel at market prices which included more profit for United States Steel. This is, in effect, a pyramiding of profits for one company.

Based on these audit results, the agreement, and the contract, the shipbuilder requested a price reduction from United States Steel. The shipbuilder initially suggested that only 8 percent profit was reasonable, but later offered 17 percent.

United States Steel responded to both requests by stating that:

> As we have stated to you in the past on such occasions, our prices are not subject to change on the basis of audit by the Government. Therefore, we must decline your request to reduce our prices.

Thus, the agreement to a maximum price subject to further negotiation was made worthless by the company's refusal to lower its prices.

Now, I think it would also be appropriate to read you a summary of the Kefauver report regarding pricing practices in the steel industry. I knew Senator Kefauver and I followed the hearings he chaired for the Senate Subcommittee on Anti-Trust and Monopoly. In fact, when his report was issued in 1958, I read all four volumes on the steel industry. This subcommittee's work impressed me very much.

Here are a few of the committee's conclusions.

> Outside of natural monopilies which are regulated in the public interest, the political philosophy which governs this economy rests upon the concept of competition. The theory is that free play of competitive forces provides the best method of making prices properly responsive to changes in market conditions and is thus the best way of assuring a proper allocation and use of resources.
>
> It is apparent that, in a number of important respects, the characteristics of the steel industry are quite different from those associated with the economic models on which competitive theory was originally based. Notable among these differences are the high levels of concentration in the market, the long-established practice of price leadership which appears to operate just as effectively when prices are increased as when they are reduced; the relative absence of newcomers; the historical use of elaborate pricing systems which have produced complete identity of given prices at any given point of destination and so on.
>
> Of even greater importance is the insensitivity of the industry's prices to changes in market conditions. Indeed, it is more than just insensitivity. Since World War II prices have moved on a number of occasions in the opposite direction to that which would have been indicated by the changes in demand. Thus, the steel price index continued its virtually unbroken rise even when

demand and production declined (as they did in 1949, 1954, and 1957). It also continued its climb even when unit labor costs declined (as they did in 1950 and 1955). No matter what the change in cost or demand, steel prices since 1947 have moved steadily an regularly in only one direction, upward * * *

In many industries, prices may move contrary to the directions indicated by the changes in market conditions without causing any substantial injury to the public interest. But this is not true of steel, which is the underpinning of our entire economy. When the price of steel goes up, the inevitable tendency is for steel-consuming industries to raise their prices. To the extent the demand in the steel-consuming industries is responsive to changes in prices, the higher prices will tend to reduce their sales, their output, their employment, and also their demand for steel. Faced with a decline in demand, the steel companies can be expected to reduce their output, which would cause their overhead costs to be spread over a lesser number of units, resulting in higher total unit costs. This, in turn, may provide a rationale for still further price increases. In this way a vicious cycle of price increase, lower demand, and higher unit costs may be set in motion.

In an administered price industry such as steel there is no built-in mechanism which would automatically bring such a cycle to a halt. If recourse is taken to fiscal and monetary measures, employment may be restored, but only at a constantly higher level of prices * * *

In summary, the subcommittee found that the steel industry, led by United States Steel, distorted the normal market economic rules of supply and demand by artificially administering their prices. The net result is disruption in the economy, inflation accompanied by declining demand and rising unemployment, and the anticompetitive pricing policies of the steel industry are responsible.

Senator PROXMIRE. That was 1958, 17 years ago. It is a very, very accurate description of what has happened in the past couple years.

Admiral RICKOVER. And I have another statement I would want to——

Senator PROXMIRE. Before you get to that, let me point out that last year, I would say from May of 1973 until May 1974, the steel prices increased 45 percent in 1 year, by far the biggest increase in a single year in our history.

The biggest increase previously was in 1947, about 21 percent. This was because of the colossal power of United States Steel, the fact that it is the price leader and that it took advantage of the demand situation to push their price up.

Now, what you point out in quoting Senator Kefauver is that it always goes one way. It never goes down. At the present time we have a weak demand for steel. They are operating below 80 percent capacity. Yet, what is the situation? They are putting prices up again.

It never goes down, it always goes up. We had hearings before the Joint Economic Committee last year; no justification for the price increase was shown. I think the price increases were twice as great as their cost increases.

So there is no question that this remarkable statement that you have read to us from Senator Kefauver of 17 years ago has indicated the course of steel now. Now the great weakness is that that philosophy and power are spreading to other industries. We are getting it in aluminum, in chemicals, we are getting it in automobiles. They are increasing their prices with a weak demand. It is one of the things that is affecting our economy and driving us toward double-digit inflation.

Admiral RICKOVER. As you know, I am a student of history. In my view, one interesting aspect of history concerns the relationship be-

tween industry and other institutions in social organizations. For example, the corporate state established by Mussolini in the 1920's was comprised of three units: a federation of employers, a labor syndicate, and government representation, which was supposed to safeguard the interests of society. Thus, industry constituted one branch of government. In the United States, we define the state in terms of the executive, the legislative, and the judiciary. Yet today, corporations in this country have become the equivalent of a fourth branch of Government, but one without responsibilities. This vast power of corporations is not readily apparent to the public.

I might ask, sir, why do you permit this situation to persist? You are a representative of the people. Congress makes the laws. The executive branch may not carry out the laws which you enact, but there is nothing to stop you from making laws that can be carried out. That is your job.

Therefore, I can accuse you of not doing your job.

Senator PROXMIRE. I assume you are making that accusation in a collective sense, of the U.S. Senate.

Admiral RICKOVER. Oh, yes, sir. However, I understand no Senator publicly criticizes his colleagues. Therefore, you have to accept this censure yourself. Otherwise you might be considered disloyal to the Senate, sir.

Senator PROXMIRE. Did you want to read another statement?

Admiral RICKOVER. Excuse me, sir, you understand the spirit in which I say this?

Senator PROXMIRE. Of course.

Admiral RICKOVER. And I——

Senator PROXMIRE. You are about the only witness I know who can insult the chairman and get away with it.

Admiral RICKOVER. I am not insulting you, sir. I think you are a great guy. I know I can deal with you on equal human terms and speak candidly. No one instructs me what to say, as you well know.

Senator PROXMIRE. And no one can soften an insult more artfully than you can.

Admiral RICKOVER. I did not mean my comments as an insult, sir.

Senator PROXMIRE. All right.

Admiral RICKOVER. I have a chronology of United States Steel relations with the Navy which may help shed light on the matters under discussion. In 1947, HY–80 steel was developed by United States Steel under a Navy research program. United States Steel was the first producer.

In 1951 the Federal Trade Commission issued a consent decree providing that United States Steel Corp. and other steel producers should cease from entering into understandings and agreements—certain collusive pricing practices—including the use of pricing formulas which produce identical delivered costs.

In 1960 Lukens and United States Steel started listing steel prices as part of their price catalogs. In 1962 the Truth-in-Negotiations Act was passed.

Between 1961 and 1964 the Navy sent a series of letters to the Federal Trade Commission reporting the receipt of identical bids from United States Steel and Lukens Steel on orders for HY–80 steel, a specialty steel used almost exclusively in Navy ships.

The two companies priced their offers in such a way that when delivery costs to the shipyard are included, the prices from both are identical.

The Navy received no answer from the Federal Trade Commission. Mind you, this is 13 years after the Federal Trade Commission had issued a consent decree.

I believe the consent part of it by United States Steel was something on the order of: "If we consider we are breaking the law, we will stop." In other words, they chose, as they always do, to have their determination of the law as the final one. I think this is an issue which you understand.

On June 28, 1965, the General Accounting Office issued a report stating that during a period of 1960 to 1964, United States Steel and Lukens quoted identical prices for HY–80. The GAO also found that the Navy did not obtain cost and pricing data as required by the Truth-in-Negotiations Act on purchases of HY–80 steel.

The GAO concluded that, since the two suppliers quoted identical prices, there was not adequate competition on the steel procurements. The GAO recommended that the Navy obtain cost and pricing data on future steel purchases.

In response to the GAO report the Navy promised the GAO that cost and pricing data would be obtained on future orders of HY–80 steel.

From 1965 on, the Navy and its shipbuilders have been unsuccessful in repeated attempts to obtain cost and pricing data on procurements of HY–80 steel. United States Steel, Lukens Steel, Armco Steel, and Bethlehem Steel all refused to provide the data.

In 1967, the Defense Supply Agency, which also purchases HY–80 steel, reported to the GAO that it has obtained effective competition in purchasing of steel and, therefore, it would not require cost and pricing data from steel suppliers.

In December 1969 and January 1970, in two memoranda to the Commander, Naval Ship Systems Command, I reported on the purchase of HY–80 and another specialty steel, HY–100, at the Newport News Shipbuilding Co. The suppliers quoted prices according to a formula which makes delivered costs identical. Although the shipyard purchased several million dollars' worth annually, it did not obtain cost and pricing data.

In January 1970, the Commander, Naval Ship Systems Command, reported that he agreed with the basic facts in my reports. He directed a review of the situation and stated that in the future the Navy will consent to Newport News steel procurements only after reasonable assurance of compliance with the Truth-in-Negotiations Act and Armed Services Procurement Regulations.

On March 17, 1970, the Commander, Naval Materiel Command, his boss, reported that there was not sufficient indication that HY–80 and HY–100 prices were reasonable because delivered prices were identical. He authorized placement of contracts without cost data, to meet emergency requirements.

From January 1970 through April 1970, Newport News attempted to obtain cost data on sales of HY–80 and HY–100 steel. The companies refused. They pointed out that the Defense Supply Agency had determined in 1967 that cost data need not be furnished on these pro-

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curements and that the Navy requests for such information on Navy procurements were unwarranted.

On August 18, 1970, Senator Proxmire asked the GAO to investigate the procurement practices and cost controls at private shipyards which have large Navy ship construction contracts. He specifically requested a review of the shipyards implementation of the Truth-in-Negotiations Act.

This is 5 years ago, sir.

On October 13, 1970, I wrote to the Commander, Naval Ship Systems Command, stating there had been no change in the situation in the 10 months since his reports were prepared and I urged prompt action.

On November 23, 1970, the Assistant Secretary of the Navy, requested Department of Defense assistance in obtaining cost and pricing data for procurements of HY–80 and HY–100 steel.

On February 10, 1971, the Assistant Deputy Secretary of Defense replied that the Navy's problems in dealing with the steel companies should be resolved by the Navy. The Department of Defense would not become involved.

On March 12, 1971, the Navy General Counsel wrote to the Federal Trade Commission. He stated that the Navy shipbuilders were still receiving identical bids from suppliers of specialty steels. He requested an answer to the Navy's letters to the FTC in 1961 to 1964.

Mind you, FTC issued a consent decree in 1951, but by 1971 the Navy was still having problems on steel purchases. Maybe the Commission was preoccupied with the fair pricing of toys, pantyhose, brassieres, or some other product and did not have time to get to this issue.

In 1971, the Assistant Secretary of the Navy again wrote the Department of Defense, pointing out that the Navy did not have the economic leverage to convince the steel companies to comply with the law.

On March 25, 1971, the Navy asked the General Accounting Office to audit the steel company's production costs for HY–80 and HY–100 steel.

On April 9, 1971, the Assistant Secretary of Defense replied to the Navy. He reiterated that the steel problem was the Navy's problem. However, he agreed to talk it over with naval officials when he got a chance.

In December 1971, the Federal Trade Commission began an investigation into charges of collusive bidding practices of HY–80 and HY–100.

On July 7, 1972, a GAO report verified the findings of my 1969 and 1970 reports and confirmed that the findings of the 1965 GAO audit were still valid.

In 1974 the FTC charged Lukens and United States Steel with violation of the 1951 consent decree. That is hardly a marvelous accomplishment considering that more than a decade had passed since the Navy first reported its problems on steel procurements to the Commission.

Now that same situation is still going on.

You know, I am getting on in age. I very much doubt in my lifetime—possibly in the lifetime of your children—that you will get United States Steel to comply with the law. I do not blame you, Mr. Chairman, because no one else has been able to succeed in this task.

Perhaps Congress should frankly recognize that we have companies in the United States which put themselves above the law. Then we could appoint an Ambassador to these organizations and even try to negotiate something like a SALT agreement with the steel companies or other such companies that are large and influential enough to evade the law succesfully.

So long as the executive branch will not enforce the law, so long as Congress tolerates the situation, I see no other recourse.

Senator PROXMIRE. Well, I think—go ahead.

Admiral RICKOVER. If you do not mind, sir, I would like to make a philosophical observation.

Senator PROXMIRE. I have some questions I would like to ask you.

Admiral RICKOVER. How much time do I have?

Senator PROXMIRE. Well, I want you to take whatever time you require.

Admiral RICKOVER. I would like to make some analogies, sir.

I think the United States is faced with the greatest crisis it has ever faced, including the Civil War, because slavery was on the way out anyway. The problem of slavery would have been resolved with or without war. We were about the last country to permit slavery and as a result of various economic and trade conditions, it was bound to dissolve in time.

But the energy situation is unique in our history. As you know, I am not a newcomer to the problem. In testimony before the Congress over 20 years ago, I was pointing out the problem.

The energy situation is a complex crisis. It is not being handled properly because it is difficult to persuade people who are accustomed to an easy way of living to support the necessary legislation which would curtail their activities. Many Americans do not accept the fact that unless something drastic is done now, we will be out of oil in about 25 years.

Some will argue that we will have oil from coal or shale, or point to fusion power. But these developments are far distant and their costs will be tremendous. Therefore, whether in terms of industry, labor, or government, it is time the country got together and realized the dire situation we face. Instead we waste our time bickering among ourselves, as we are doing here today. Rather than working on clever ways around the law, officials of United States Steel should be finding better ways of making steel. There is more important work to do.

An analogous situation existed in France just before the revolution in 1789. The country was on the verge of bankruptcy and this dilemma forced the King to convene the Estates-General, the three-part legislature of feudal France consisting of representatives of the clergy, the nobility, and the "third estate," composed of the people at large. The King had not convened the Estates-General in 150 years but in no other way could he obtain the moneys needed to run France. Feudal law severely restricted the King's taxing power, limiting it to his personal domain—never more than a relatively small part of the entire realm. To obtain additional funds, he needed the consent of the Estates-General and this was rarely given without the exaction of concessions limiting royal power. This is what happened on the eve of the French Revolution.

Reflecting feudal privilege, the three estates had equal voting power, even though the bulk of the people was represented in the third estate. In 1789, the third estate was, however, no longer willing to put up with this inequality. It demanded and obtained voting power equal to that of the two other estates combined, whereupon these refused to sit jointly. The result was that the third estate—which represented 96 percent of the electorate who paid nearly all of the taxes—proclaimed itself the national assembly and this in turn led to the revolution.

I think we are in a similarly fragmented situation right now. Why should we have to spend our time jousting with one or more large corporations who choose to be above the law instead of solving more fundamental problems?

I would like to call on business leaders who are supposed to have imagination, to do something more constructive.

Instead, many businessmen seem consumed by self-interest. I am reminded of the grandson of John Quincy Adams who, looking back on a lifetime of association with other businessmen, expressed his disillusion with the world of trade and commerce. Around 1880, he noted of businessmen, "Not one that I have ever known would I care to meet again, either in this world or the next, nor is one of them associated in my mind with the idea of humor, thought or refinement."

Mr. Chairman, I would like to see a change in this image of businessmen, but such a change will depend upon reforms within the business community itself. Until then, public trust in business will continue to diminish. In 1966, the Harris Poll reported that 55 percent of those questioned expressed a great deal of confidence in the people running our major companies. But by the fall of 1974, this level of public confidence had fallen to 21 percent—the greatest decline of any of the major institutions whose image was evaluated by the poll.

Those in our country who receive its greatest benefits, who enjoy high salaries, and other guaranteed benefits, should not take so much advantage of their position for strictly monetary or any other personal gain. The ordinary man with a family of four or five is the one whose children fight our wars. He has to pay his income taxes. But the business people have large salaries, expense accounts, retirement benefits, and so on. Yet they are still out after more money. What good is all this wealth unless they can use it in the life hereafter? I personally doubt money will be of much use where they are going.

At this point, sir, I am finished with my philosophy and I will try to answer your questions.

Senator PROXMIRE. Thank you, sir. I am happy that you took the time to go into that, because I think the impromptu case you made is just devastating.

The data you supplied are a comprehensive indictment of the policies of United States Steel to prevent competition, and engaging in price fixing. It stands in some contrast to the statements of Mr. Roderick this morning, and I quote one short paragraph from his statement:

> Perhaps there should be more effort by the Department of Defense to coordinate procurements or at least conduct the necessary missionary work, to assure the availability of multiple sources for response to the solicitation of bids for these products. The objective of maximizing competition should be vigorously

pursued in all defense procurements, and I firmly believe that competitive bidding, rather than negotiation of price based on costs, will in the long run produce the lowest cost of national defense.

Admiral RICKOVER. I thoroughly agree with that statement, providing there is true competition.

Senator PROXMIRE. Well, so do I.

Admiral RICKOVER. Then why are you questioning me about it?

Senator PROXMIRE. Well, I am asking you how you would reconcile that with the record of United States Steel?

Admiral RICKOVER. I would say, actions speak louder than words, sir.

Senator PROXMIRE. Very good.

Now, Admiral, I have voiced skepticism about the agreement with United States Steel on the Cost Accounting Standards contained in United States Steel's letter, which you are familiar with, to Mr. Schoenhaut, of August 15. (Letter, exhibit 15.)

Admiral RICKOVER. Yes, and I picked out the keyword "applicable."

Senator PROXMIRE. As you see, it is complicated and left me with questions as to whether they will comply. Do you know of previous agreements in complying with procurement regulations?

Admiral RICKOVER All I know about United States Steel is that they have never agreed to any competitive situation except as defined by Roger Blough, their previous chairman of the board. It is based on the notion that competition exists when United States Steel says competition exists.

Senator PROXMIRE. In their relationship with the Navy, and with you and your procurement in the Navy, was effective compliance achieved?

Admiral RICKOVER. Well, what I have found in the Defense Department is that the officials will not stand up to this issue.

Senator PROXMIRE. Why?

Admiral RICKOVER. Well, I was waiting for that.

As a matter of philosophy, the Department and the Navy get business people to run the civilian element, that is, the Secretaries and various Assistant and Under Secretaries, and their sentiments often favor the industry viewpoint. I am not arguing about civilian control of the military.

I am a complete and firm believer in civilian control of the military. But you must remember the statement made by Charles E. Wilson, of General Motors, when he became Secretary of Defense. He said, "What is good for General Motors is good for the United States."

That was not a bad statement if people understand his philosophy. Here is a man who was brought up in business, and honestly believed that what was good for General Motors was good for general defense. There is a logical tendency among government officials who have a business orientation to lean over backward for business and to feel they are responsible for the welfare of business.

They want to be sure of a secure industrial base. I understand that. But at the same time these officials should understand that their job, when they assumed that oath of office, is to protect the public interest and execute the laws of the United States. They are no longer businessmen.

I very much doubt whether you can take a mature man over 30 years old and get him to change his views. Therefore, civil service people with longstanding government experience should be promoted to these jobs rather than businessmen who stay for a few years and then return to the private sector.

This is the real issue. Too many Government officials concern themselves with the welfare of business rather than the Government's welfare.

You are familiar with the case of citizens who are sent abroad to represent us in foreign countries. Pretty soon they refer to the host nation as "my country" and they become representatives of these foreign countries to the United States rather than representatives of the United States to these foreign nations. They are always concerning themselves with the welfare of the countries to which they are accredited rather than with the welfare of the United States. Similarly, some Defense officials seem more concerned with the problems of industry than with protecting the interests of the public at large. I am not imputing any evil intentions here. I am simply making an observation.

As for the case of United States Steel honoring its agreement, you must remember the clause I read previously. This clause states that regardless of what is written in the contract, only United States Steel's terms cited in their standard acceptance form apply. If the buyer allows this final United States Steel clause to stand, United States Steel becomes the final arbiter of what the contract says rather than the contract itself defining the agreements of the parties. Once you accept the material you have no legal standing.

Another example of United States Steel's honoring agreements is the case I mentioned earlier—where the company refused to negotiate a lower price when a Government audit showed the company would be making a 39 percent profit—far greater than allowed by Government regulations. There you are. We just cannot do anything with United States Steel.

Senator PROXMIRE. Let me follow up on that. I think one of the most interesting revelations that has been made or analysis that has been made, because it was your perception that made it available to the committee, was the fact that they do accept the contract and not sign the contract. This is a very interesting departure. It seems to give them a way of technically avoiding accountability for contract provisions.

Admiral RICKOVER. That is why I ended my speech with the statement, "Law is no substitute for justice."

Senator PROXMIRE. Right. Now, by accepting the contract and not signing it, your position is that United States Steel avoids compliance with any terms, laws, or regulations it chooses not to observe; is that right?

Admiral RICKOVER. That is my opinion.

Senator PROXMIRE. Does it require legislation to mandate that contractors and subcontractors sign contracts?

Admiral RICKOVER. That may be necessary. It is possible that we have never had any legal contracts with United States Steel in the past.

Senator PROXMIRE. It seems to me this practice could spread. I don't know why any other business couldn't do it.

Admiral RICKOVER. They may find out about it from this hearing. Maybe they do not know about it yet. This hearing may be a very bad thing.

Senator PROXMIRE. Not if we act on it, if we proceed to change the law so we will require a signature.

Admiral RICKOVER. I would strongly recommend corrective action. Take the Truth-in-Negotiations Act. That act was not intended to cost the government more money; it was to apply to noncompetitive procurement situations. When you enact a law of that kind, you should expect it to be strictly enforced. If you find that you are not getting strict enforcement, corrective action is needed.

I think the whole relationship between Government agencies and contractors may require some sort of an ethical code. I do not know what you would call it, but such a code could be the subject of legislation.

I think the time is right to develop such a code, because people in this country are more aware than ever of the dire situation we face today.

Senator PROXMIRE. Admiral, as an expert on Navy procurement you are in a position perhaps to help us on this. We have gotten a very vigorous argument by Mr. Roderick that United States Steel has been very cooperative in the instant case involving the Connecticut shipbuilding firm. We have gotten the Defense Department to say they are uncooperative. Who is right?

Admiral RICKOVER. The Defense Department. You can cooperate with United States Steel so long as you do all the cooperating.

Senator PROXMIRE. You think that is so in this case?

Admiral RICKOVER. Yes; when people talk of cooperation, it is——

Senator PROXMIRE. We do have an apparent situation in which United States Steel has agreed to abide by the Cost Accounting Standards of the law and they did go that far. You regard that not as evidence of cooperation?

Admiral RICKOVER. I know of no legal contracts which bind United States Steel to this agreement.

Senator PROXMIRE. Because it is not a legal contract. I see.

Admiral RICKOVER. Not legal. I think this may be how they will get around the Federal Trade Commission consent order. I do not know all that has happened on this issue since 1951, but I do know that United States Steel has lots of lawyers and certainly any lawyer worth his salt can figure out words which negate the intent of any law. I think you may find that the key to many problems with that is a factor which should be considered in any legislation that you are thinking about.

In the present case I would suggest that you address a letter to the United States Steel Corp. and point out these problems. When the company agrees to something, get it in writing and make it contractually binding.

Senator PROXMIRE. All right.

Admiral RICKOVER. And, do not simply take the company's word for it, sir.

I do not want to impugn the integrity of Mr. Roderick. But Mr. Roderick has taken over a company which has been traditionally run this way. His job is to make money for the stockholders, and as much as he can. If does not make enough money, the company will hire somebody else who can.

Senator PROXMIRE. When the Deputy Assistant Secretary of Defense for Procurement, Mr. Babione, testified yesterday, he stated that he felt United States Steel could make arrangements to sign the five subcontracts with Eelectric Boat within 90 days.

No. 1, you say—and I take it on the basis of the testimony we have from Mr. Roderick this morning; it is his position, too—that this will not be signed. It will be accepted within 90 days.

Admiral RICKOVER. That is right. Furthermore, I could ask this question: Why 90 days?

Senator PROXMIRE. I was going to ask you that. Is it realistic?

Admiral RICKOVER. If they mean what they say, why wait 90 days?

Senator PROXMIRE. That wasn't Mr. Roderick's position. It was the Defense Department's position. They said it would be 90 days. Now, should it be within 30 days, do you feel?

Admiral RICKOVER. Since the company says they are manufacturing the steel, and I believe they are, and since they have agreed to comply with the law, then why don't they sign the contract now, not 90 days from now?

Senator PROXMIRE. I would like to raise another issue that came up in testimony yesterday. Last month I asked General Bray of the Federal Preparedness Agency whether contractors could refuse to accept a defense-rated order if it contained provisions which the contractor did not like. (Letter, exhibit 3, p. 117.)

On July 17, General Bray replied by letter to my query and the letter has been circulated to the services and throughout the Department of Defense. I feel that General Bray was quite definite and forthright in replying that the Defense Production Act and implementing regulations do not provide a basis for such a refusal. Yet yesterday we were told that the Defense Department interprets the letter in exactly the opposite way.

Do you think the Defense Department is correct that industry can refuse a defense-rated order and there is no power to compel performance?

Admiral RICKOVER. No, sir, I have read General Bray's letter, It is a very carefully engineered letter, which is typical of that comes out of the Department of Commerce.

Senator PROXMIRE. Department of Commerce?

Admiral RICKOVER. No, General Bray is in the Federal Preparedness Agency which joins the Department of Commerce in administering the Defense Production Act.

I have had experience with the Department of Commerce in connection with another important contract that was holding up the design and construction of a submarine. As a matter of fact, in terms of assistance on that problem, the Department of Commerce was about as useful to us as a lighthouse without a light. I would place no credence in the Department of Commerce from what I have seen of past actions and I think General Bray should be asked to make his letter more de-

finitive. I think it is subject to interpretation. In my opinion, however, his letter says that the Defense Production Act can be used to require a contractor to accept and perform contracts; that such contracts must include all clauses required by law or regulation; but that if a contractor subsequently fails to comply with such clauses, laws or regulations, it is up to the procurement agency to take legal action to enforce the contract.

Senator PROXMIRE. Which actions do you think should be imposed on contractors when they seek to avoid Government standards by refusing to sign contracts or refusing to provide essential hardware?

Admiral RICKOVER. The only recourse is what would you do with a man who refuses to pay income taxes or comply with any other law? I would put him in jail.

Senator PROXMIRE. What I am getting at, you see, is that the Defense Department says they have not the power to compel them to perform.

Admiral RICKOVER. If the Defense Department wanted to take action, they could. But the letter is broad enough so that if you do not want to take action you can always find some clause which gets you off the hook. I think it is entirely a case of policy in the Defense Department.

Senator PROXMIRE. There is another provision in the law——

Admiral RICKOVER. I have something else to add, sir.

Senator PROXMIRE. Go right ahead.

Admiral RICKOVER. The Defense Production Act already provides fines and penalties for contractors who do not comply with provisions of the law. Also, Senator Jackson has attached a rider to the fiscal year 1976 DOD Appropriation Act which I understand provides further penalties for contractors who refuse to provide the Armed Services with petroleum products. This rider stipulates that mandatory orders for petroleum products must be accepted on terms consistent with applicable procurement regulations and these would include Cost Accounting Standards and the requirements of Truth-in-Negotiations. Congress should consider broadening this legislation to apply to all defense procurements.

Senator PROXMIRE. The other provision I would like to mention is the provision for exemptions and waivers. As we have seen in the case before us, there is the possibility that a sole source contractor can obtain a waiver or exemption from Cost Accounting Standards by simply refusing to supply urgently needed military goods. This may be a built-in invitation to blackmail. What I would like to know is what other remedies you have to suggest or do we need to alter the legislation?

Admiral RICKOVER. One remedy I see, of course, is that the Defense Department could use the Defense Production Act. The only necessity there is to clear up General Bray's letter to have it carry out the intent of the law, which is to take care of that very situation.

If you have a sole-source contract and the vendor refuses to perform the work and comply with all procurement laws and regulations, you make the language of the law so simple that it cannot be misinterpreted.

Senator PROXMIRE. Neither the cost accounting legislation nor the Truth-in-Negotiations Act are applicable to standard commercial ar-

ticles sold in substantial quantities to the general public. Is there any way that HY–80 steel could conceivably fall into that category?

Admiral RICKOVER. No, sir, there is not. HY–80 is a highly specialized steel which has characteristics which are too costly for most commercial uses. It has a military value as well as a value in some laboratory situations. I doubt such specialty steel will ever be sold commercially in significant quantities. It was developed by the Navy for naval use and practically all of it is used by the Navy.

Senator PROXMIRE. Mr. Roderick suggested that the Defense Department avoid sole source procurements by stimulating more capacity?

Admiral RICKOVER. What difference would that make? We would still have to go to another steel company. Then we might find out by some chance that all four or five companies bid identical prices. I have tried to make a mathematical computation of how it could be that steel companies for a whole year could submit the same price on everything. There are many variables in such a computation but I have roughly gauged the probability at about 1 in 65 billion.

Senator PROXMIRE. Without conspiracy?

Admiral RICKOVER. You can call it conspiracy; you are in the Congress, in the legislative branch. I am in the executive branch and I cannot. But I will consider your definitions. [Laughter.]

Senator PROXMIRE. On page 2 of your statement you mention Ingersoll-Rand and Ladish. Incidentally, Ladish is a company in my State. It is in Milwaukee. I have gone there many times to shake hands with the workers. I have admiration for their management and the good job they are doing.

Admiral RICKOVER. I see their lobbyist is here, too.

Senator PROXMIRE. Is their lobbyist here? I didn't know that. I am proud of Ladish, though, and the excellent work they are doing.

Mr. Roderick maintained it to be ill-advised to use that similar language in the United States Steel case. Admiral, you are closer to this problem than I am. Is "threat" too strong a word for what is taking place in these cases?

Admiral RICKOVER. No.

Senator PROXMIRE. If your word couldn't be heard, it was "no"?

Admiral RICKOVER. The word is "no," sir.

Senator PROXMIRE. I think the testimony yesterday brought out, perhaps indirectly, that there is a certain problem insuring that the Cost Accounting Standards will be adequately enforced when applicable. In view of the Defense Department's management objective calling for action to reduce the impact of the Standards, this problem is larger and more immediate. Do you have any suggestions as to how compliance can be regularly enforced?

Admiral RICKOVER. Well, here is what I said in my statement: "An independent agency such as the General Accounting Office should periodically perform an audit to insure that agency procedures for compliance with these laws and regulations"—that includes Cost Accounting Standards as well as the Truth-in-Negotiations Act—"are adequate and that the agencies are complying with their own procedures. The GAO should report its findings to Congress and Congress should re-

quire procuring agencies to identify corrective action and a schedule for implementing such action."

I also said in my recommendations in my prepared statement that: "Procuring agencies, including the Department of Defense, should insure that their procedures for monitoring compliance with procurement regulations are strict enough to insure that the exemptions provided under the laws and regulations will not be abused. Emphasis should be placed on how exemptions already provided are interpreted and applied. The actions should insure that procurement officials do not abuse exemptions provided by law or regulation."

Senator PROXMIRE. OK.

Admiral RICKOVER. I think at this point, sir, it is really up to Congress to strengthen the law.

Senator PROXMIRE. Admiral, I would like to conclude these hearings. You have been a very helpful and extraordinarily useful witness, as always. But I would conclude these hearings by making a final statement that is final except for any word you would like to add after I finish.

At the end of 2 days of hearings on the issue of whether United States Steel and other companies are willing to comply with the Cost Accounting Standards, there are a number of conclusions which can be made.

First and foremost, I am struck with the alacrity with which United States Steel and the Department of Defense, in particular, said they were able to solve this problem after it received a certain notoriety. Sunlight and public disclosure are great disinfectants. Of course, this may last as long as the sun stays out.

In addition, we have found out certain other things.

After years of either failing to comply with the Standards or assertions that they will not or cannot comply with the Standards, United States Steel has now, so they say, found it quite simple and quite easy to meet the Standards and in this case familiarity has not bred contempt but easy acceptance.

It is a fair statement, I believe, to say that the Department of Defense has been lax in its job of enforcement and compliance. Unlike their actions in other areas—such as their proven effectiveness in getting their way with Congress—in the carrying out and enforcement of the Cost Accounting Standards the posture, of the Department of Defense can best be categorized as "shy" and "retiring."

In fact, there has been a spectacular failure to fight for compliance with the law. In addition to the easy manner in which compliance and enforcement has been treated, it is clear that there is a great void in our knowledge about enforcement.

How much compliance is there? What are the facts? How many cases have there been?

Our hearings have also indicated that much tougher sanctions are needed for Cost Accounting Standards violations. The present penalties of merely having to pay back excess payments plus 7 percent interest is an invitation to lawbreaking. If the law is broken, a company most likely—with the easy enforcement policy of the DoD—would not be caught. If it is caught, it merely gets a below-market rate

loan—a 7-percent loan at a time when the prime rate is much higher than that, and rising.

We have learned about the waiver authority. In my view it would be a mistake to delegate it to the Department of Defense. It would be a worse mistake if it were delegated down the chain of command to a minor official in the field. Such authority should be granted in only rare instances and in exceptional and unusual circumstances by people in the highest echelons of authority. This is no function for minor civil servants.

We have also found that exceptions could become the rule.

The view of the Department of Defense is that since the administrative procedures have not been exhausted until a waiver claim has been submitted and acted upon, it is their duty to recommend a waiver in each case where a big company insists upon it.

There are two final points I want to make.

One, I think it is clear that there is now a concerted effort brewing on the part of industry and the Defense Department to cripple the Cost Accounting Standards requirements. Big companies are routinely seeking waivers. The DoD spinelessly forwards them. We now have further evidence that, as a part of their "management by objectives" program, the DoD is seeking further exceptions.

While these hearings may have nipped this initial effort in the bud, we must be vigilant against further encroachments. The difference between the tough attitude—even swashbuckling attitude that many told us United States Steel took at the beginning and as Admiral Rickover detailed in his history of United States Steel actions—as compared with their public attitude of compliance and reasonableness today, should warn us as to what will happen in the future.

For that reason this committee will keep its guard up and its record open and its oversight function in full gear.

Finally, we have here an unresolved conflict in testimony between United States Steel Corp. and the Defense Department over whether or not United States Steel used blackmail tactics and threatened to withhold its defense products from the Government, or whether, as its chief officer has stated today, the company met order after order on a timely basis with neither any threats of refusal to deliver or any actual failure to deliver in a timely way.

That issue is in direct conflict and remains to be settled. Both cannot be right and we will be keeping our record open for further determination in that regard. Either side may be right or wrong.

Admiral, is there anything you would like to add?

Admiral RICKOVER. Yes, sir.

I deeply appreciate this opportunity to talk with the Joint Committee. As you know, I personally feel deeply about the perils facing this country, not only in a military sense but, even more importantly, in economic, cultural, and spirtual ways. I am troubled about our Nation's future.

Therefore, I welcome the opportunity to talk to Members of Congress, particularly people such as yourself. I want to thank you very much for this opportunity, sir.

I also would like to add that I listened carefully to what you have said, particularly in your summation. You have a thorough under-

standing of the situation. Your remark about the sun being a strong distinfectant is particularly appropriate.

In this case, you are the sun, and you must keep on shining.

United States Steel has stated they will comply with the law. I merely quote the Bible, "By their deeds shall you know them."

Thank you, sir.

Senator PROXMIRE. Thank you very much, Admiral.

The Joint Committee will stand in recess, and the record will remain open for the time being.

[Whereupon, the committee was recessed at 12:45 p.m. to reconvene at the call of the Chair.]

EXHIBIT 1

COST ACCOUNTING STANDARDS BOARD
441 G STREET, N.W.
WASHINGTON, D.C. 20548
Telephone: (202) 386-6213

ELMER B. STAATS
Chairman
HERMAN W. BEVIS
ROBERT K. MAUTZ
TERENCE E. McCLARY
JOHN M. WALKER

ARTHUR SCHOENHAUT
Executive Secretary

August 29, 1975

Senator William Proxmire, Vice Chairman
Joint Committee on Defense Production
United States Congress
Washington, D.C. 20510

Dear Mr. Chairman:

At the conclusion of my testimony on August 20, 1975, during the Hearing of the Joint Committee on Defense Production on Cost Accounting Standards, waivers, and compliance, you asked me to supply information on the exemption request submitted to the Cost Accounting Standards Board by the Aluminum Company of America.

I enclose two letters to me from the Aluminum Company of America, dated June 30, 1975, and August 28, 1975. The June 30 letter requests an exemption for all prime contract and subcontract awards made to the Aluminum Company of America. The later letter provides, in support of that request, the detailed information which you itemized on August 20.

The Cost Accounting Standards Board has not yet placed this exemption request on its agenda for Board consideration.

Sincerely yours,

Paul R McGann
for Arthur Schoenhaut
Executive Secretary

Enclosures

ALUMINUM COMPANY OF AMERICA
ALCOA BUILDING, PITTSBURGH, PENNSYLVANIA 15219
D. J. MAHRER, Senior Assistant Controller

June 30, 1975

Mr. Arthur Schoenhaut, Executive Secretary
Cost Accounting Standards Board
441 G Street, N.W.
Washington, D.C. 20548

Dear Art:

Messrs. Lersch, Hartman, Manfred and I wish to thank you and the CASB staff for giving us the opportunity to exchange thoughts with you relative to the position of Alcoa in the government procurement/CAS picture. We feel that such an exchange is beneficial to both parties even though we may not reach agreement in all issues.

As we explained, we had thought that with the increase in the threshold dollar value of an order subject to CAS we might be exempt from the Board's requirements, but we now find that with the receipt of some customer purchase orders in excess of the threshold amount, and the proposed inclusion of subcontracts in the Disclosure Statement requirement threshold base, we must continue our efforts to obtain an exemption or waiver from the requirements of Cost Accounting Standards.

We hope that we conveyed to you and the staff our concern over the situation that we find ourselves in -- or that situation that we think may tend to come about. It is our basic contention, that to change a system we have "tailor made" to our own operational needs in order to accommodate requirements peculiar to a small fraction of the business, has no economic or other advantage that can justify such a change. As you consider our case for exemption/waiver we wish you to remember some of the points we brought out during our meeting -- among them:

- Our Total Cost Type Prime Contracts in CY 1974 were valued at $640,000 and were all performed at our Research Laboratories. We have <u>no</u> "cost type" business in our common production facilities.

- Our parent company business (A. C. O. A.) subject to renegotiation (in 1974) was $129.4 million or 6.4% of our sales.

- Our business subject to PL 87-653 -- based on awards in CY 1974 was $7.9 million 0.4% of our sales.

- Our business that carries a CAS clause (whether or not it is a bona fide flowdown) based on CY 1974 awards is $25.5 million or 1.3% of our sales. This CAS covered business is in eight product lines at seven locations, where it represents between 0.1% and 11.4% of these product sales.

- We have no facilities that are devoted to government business alone. Our business, subject to renegotiation, PL 87-653 and CAS, is commingled with our commercial business and produced on the same common facilities used to produce our basic mill shapes.

- We use a "sidebar" system of memo records to accommodate our PL 87-653, ASPR XV and CAS covered business.

- We have 72 people at 56 sales office locations abstracting an average 160,000 customer purchase orders per year, entering 200,000 sales orders from those P.O.'s for over 400,000 order items. Orders with CAS clauses included in the 160,000 are estimated as less than 500 in number.

In summary, the Cost Accounting Standards Board and its staff are now exploring areas and writing standards that impinge on our basic accounting bookkeeping systems. The day is fast approaching or is here when memo records or "sidebar" accounting treatment will not enable us to comply with the rules and we will have to expand to a third system or restructure our basic system. We see no benefit from our position in adopting CASB standards. However, if we must conform, it is our management's intent to recover any CAS expense or effort by increasing the prices charged for those items which carry a CAS obligation. Thus, the end result to the government would be opposite to that contemplated by the legislation which established the Cost Accounting Standards Board. As you pointed out, our alternative to conforming and quoting higher prices is to decline to accept business which carries a CAS obligation. If we drop out of this marketplace - the end result again would be higher prices to government. Not participating in CAS type business bothers our sense of good citizenship and is a position of last recourse.

We would appreciate your giving our request for exemption/waiver from CASB requirements your earliest possible consideration since we feel that we can no longer delay our recommendations to our management in this area.

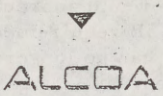
Very truly yours,

D. J. Maher/dw

DJM:dw

63-923 O - 76 - 8

ALUMINUM COMPANY OF AMERICA
ALCOA BUILDING, PITTSBURGH, PENNSYLVANIA 15219
D. J. MAHRER, Senior Assistant Controller



August 28, 1975

Mr. Arthur Schoenhaut
Executive Secretary
Cost Accounting Standards Board
441 G Street, N.W., Room 4836
Washington, D. C. 20548

Dear Mr. Schoenhaut:

This letter is in response to your request for additional information so you can provide, for the record, answers to some questions asked by Senator Proxmire on August 20 in a hearing of the Joint Committee on Defense Production. You will probably want to submit this letter and an earlier one dated June 30, 1975 for that purpose.

We trust that Senator Proxmire is aware that no particular contracts are involved in Aluminum Company of America's (Alcoa) request for an exemption, which is in accordance with the legislation which established the Cost Accounting Standards Board. The statute authorizes the Board to exempt "classes or categories of defense contractors or subcontractors" as the Board may consider appropriate. The legislation also instructs the Board to "take into account the probable costs of implementation compared to the probable benefits."

Alcoa is a predominantly commercial company with estimated sales subject to Cost Accounting Standards (CAS) amounting to less than one-half of 1% of total sales. Practically all of these are subcontracts for basic mill shapes -- castings, extrusions, forgings, plate, sheet, etc. made on the same facilities as are used for commercial business. We do not make subassemblies, assemblies, systems, or other complex items purchased by the government. As we have advised you on various occasions, our cost accounting system is specifically designed to provide management with information which it needs for cost and operating control and other internal purposes. Adoption of CAS would not replace this system but, based on our interpretation of standards proposed and promulgated, would require another system. Because of the unavoidable

comingling of commercial and government business, we visualize incurring high costs for this small amount of business in order to conform, so it seems reasonable and proper for Alcoa to solicit an exemption as provided for in the statute.

The provision for exemption written into the statute appears to support the concern of Congress that CAS would be applied to "classes or categories of defense contractors or subcontractors" in situations where it would not be appropriate. From the time Cost Accounting Standards were first issued, Alcoa felt that basic material suppliers such as itself did not make items of the type which the Congress had in mind when it provided for CAS. Accordingly, Alcoa has been discussing the subject of an exemption with members of the CASB staff since 1971. The latest activities consist of our meeting with you and other members of the staff on June 25, 1975, my letter of June 30, 1975 reiterating some of the reasons why we think we should be exempt, and the upcoming meeting in Pittsburgh on September 11.

To respond to questions asked you by Senator Proxmire concerning our request for an exemption, you requested an analysis of data contained in my letter of June 30 to you. In it, we said that, for calendar year 1974, we had awards of $25.5 million which carried a CAS clause regardless of whether it was a bona fide flowdown of this obligation to us as a subcontractor. As stated in our comments in connection with the proposed Disclosure Statement threshold, we have observed that customers who have prime contracts or higher-tier subcontracts with a CAS obligation routinely include a similar requirement in their orders or subcontracts placed with suppliers, even where such a requirement is not applicable. Examples are purchase orders where the total amount is less than $100,000; a catalog or market price is involved; the subcontract is under an advertised prime contract; or the award is competitive. Under any of these circumstances, CAS, by statute, does not apply.

A new internal technique was instituted July 1 of this year to screen orders received by Alcoa. This was done only to more positively identify orders subject to CAS and eliminate those which improperly state it is applicable; this screening procedure serves no other purpose. Cost of operating the system has not been established, but it does represent still more government burden for Alcoa and, in some cases, our customers.

You will be interested in learning that, for the seven weeks this new screening technique has been in operation, we have not received one prime or subcontract which is subject to CAS. We realize this is only a very limited period of time, but in our business, we have a fairly steady flow of orders and so consider this lack of orders subject to CAS to be rather significant as it demonstrates how little of our business is government-related.

In an effort to demonstrate that all orders we receive bearing a CAS obligation are not really subject to CAS, we made a study of the previously mentioned $25.5 million of awards for calendar year 1974 which carried this clause to identify those for which we submitted cost breakdowns as required by P.L. 87-653. Shown below are the results. We believe compliance with P.L. 87-653 is a better indicator of our CAS exposure than the mere reference to a CAS requirement on a customer purchase order. This latter category is the one for which we are also providing a further analysis showing our customers (who may be the prime contractor, although we cannot readily establish this fact), the relevant government agencies, and the Alcoa plants involved.

Product Line or Service	Alleged To Be Subject to CAS (Estimated on Basis of 1974 Contract Awards) Million $	
	Total	Subject to P.L. 87-653
Subcontracts		
Sheet and Plate	8.4	0
Extruded Products	3.0	0.5
Forgings	2.9	2.9
Wire, Rod and Bar	1.2	0
Premium Castings	1.0	1.0
Drawn Tube	0.7	0
Rivets and Fasteners	0.4	0
Ingot	0.1	0
	17.7	4.4
Prime Contracts		
Repair of Government-Owned, Company-Operated Facility (Air Force)	7.7*	7.7*
Extruded Products (Naval Supply Center)	0.1	0
Total	25.5	12.1

* A one-time repair contract unrelated to product sales.

Delivery was made from the following Alcoa plants:

	Million $
Cleveland, OH	2.0
Corona, CA	1.0
Lafayette, IN	0.5
Vernon, CA	0.9
	4.4

Alcoa customers for these product lines were:

	Million $
The Bendix Corporation	0.3
Cessna Aircraft Company	0.5
B. F. Goodrich	0.1
Grumman Aerospace Corporation	1.0
Kennedy Van Saun Corporation	0.3
LTV Aerospace	1.4
The Marquardt Company	0.4
Northrup Corporation	0.1
Sikorsky Aircraft	0.1
United Technologies Corporation	0.2
	4.4

The government agencies involved were:

	Million $
Air Force	0.9
Army	2.1
Navy	1.4
	4.4

I hope this will provide the information requested by the Senator.

Very truly yours,

D. J. Mahrer

D. J. Mahrer

/bjr

COST ACCOUNTING STANDARDS BOARD
441 G STREET, N.W.
WASHINGTON, D.C. 20548
Telephone: (202) 386-6213

October 1, 1975

The Honorable William Proxmire
Vice Chairman
Joint Committee on Defense Production
United States Congress
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed for inclusion in the record of hearings on August 20, 1975, before the Joint Committee on Defense Production is a letter dated September 26, 1975, from the Aluminum Company of America (Alcoa).

During my testimony on August 20, 1975, I referred to a forthcoming meeting with Alcoa to discuss its request dated June 30, 1975, for an exemption from Cost Accounting Standards Board requirements. The enclosed letter from Alcoa indicates that with a minor modification in its accounting system, it can comply with all of the Standards, rules and regulations that have been promulgated by the Board with little administrative effort. Accordingly, Alcoa has advised us that its request for a specific company exemption be considered withdrawn.

Sincerely yours,

Arthur Schoenhaut

Arthur Schoenhaut
Executive Secretary

Enclosure
(As stated)

ALUMINUM COMPANY OF AMERICA
ALCOA BUILDING, PITTSBURGH, PENNSYLVANIA 15219
D. J. MAHRER, Senior Assistant Controller

ALCOA

September 26, 1975

Mr. Arthur Schoenhaut, Executive Secretary
Cost Accounting Standards Board
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Schoenhaut:

We were pleased to meet with you, other members of the Cost Accounting Standards Board staff, and Defense Contract Audit Agency (DCAA) representatives in Pittsburgh on September 11 and 12, 1975. This was the most recent cooperative activity between Alcoa and the Board, which has included comments submitted by Alcoa on proposed standards, discussions, and both plant and headquarters visits by the staff.

As a result of this meeting, we recognize that an area of our accounting system would result in noncompliance with CAS 407. You agreed, and DCAA concurred from an audit standpoint, that the noncompliance could be eliminated by not including standard cost variances in contract proposals and by making available analyses of prior year standard cost variances. This change in our system has been made with little administrative effort. While there were several other areas of technical deviation, we indicated that these deviations had little or no effect on prices for government business subject to Cost Accounting Standards. You agreed that no change need be made in our system as long as the effects of these deviations remain immaterial. DCAA concurred from an audit standpoint. With the referenced modification made, we understand our accounting system as described to you at the meeting will account for costs in a manner which complies with currently promulgated Cost Accounting Standards in all important aspects.

On this basis, we now agree that there would be little administrative effort required to comply with the standards that have been issued to date. Accordingly, our request for a specific company exemption is not necessary at this time, and you are advised that the request be considered withdrawn. We hope that studies by the Cost Accounting Standards Board now in progress relative to possible modifications of the existing exemption levels will result in changes that will provide a class exemption that would encompass Alcoa's modest amount of government business now subject to Cost Accounting Standards which, as you know, is primarily firm fixed price.

We appreciate the time and interest which you, your associates, and the DCAA representatives gave to our problems. We believe that we now have a better understanding of the promulgated Cost Accounting Standards. You can be assured we will continue our active participation in future work of the Cost Accounting Standards Board.

Yours very truly,

DJM:bf

cc: Bernard B. Lynn
Headquarters-DCAA
Cameron Station
Alexandria, VA 22314

Norbert Kubczak
Defense Contract Audit Agency
527 South LaSalle Street
Chicago, IL 60605

E. W. Ochsenhirt
Defense Contract Audit Agency
1217 Federal Building
Pittsburgh, PA 15222

EXHIBIT 2

COST ACCOUNTING STANDARDS BOARD
441 G STREET, N.W.
WASHINGTON, D.C. 20548
Telephone: (202) 386-6213

ELMER B. STAATS
Chairman
HERMAN W. BEVIS
ROBERT K. MAUTZ
TERENCE E. McCLARY
JOHN M. WALKER

ARTHUR SCHOENHAUT
Executive Secretary

September 9, 1975

The Honorable William Proxmire
United States Senate

Dear Senator Proxmire:

During the hearings on August 20, 1975, before the Joint Committee on Defense Production, you requested that we provide certain information for the record. You asked for a history of the Cost Accounting Standards Board's difficulties with U. S. Steel and a list of all violations known to us of Board requirements by contractors.

We have an extensive list of companies, individuals, and professional, accounting and industry associations who assist us in our research in the development of Standards. At various stages during this development, we obtain responses from many of these individuals and organizations to questionnaires, issues papers, preliminary drafts of Standards and the initial publication of a proposed Standard in the Federal Register. Thus, interested parties have several opportunities to participate in our research process and to comment on our materials.

Following is a tabulation showing for each Standard that has been proposed or issued by the Board the extent of U. S. Steel's participation in our research process.

CAS 401--CONSISTENCY IN ESTIMATING, ACCUMULATING AND REPORTING COSTS - No response.

CAS 402--CONSISTENCY IN ALLOCATING COSTS INCURRED FOR THE SAME PURPOSE - No response.

CAS 403--ALLOCATION OF HOME OFFICE EXPENSES TO SEGMENTS - No response. By letter of June 9, 1975, U. S. Steel refused to provide statistical information desired by us in considering the extension of the application of this Standard.

CAS 404--CAPITALIZATION OF TANGIBLE ASSETS - No response.

CAS 405--ACCOUNTING FOR UNALLOWABLE COSTS - No response.

CAS 406--COST ACCOUNTING PERIOD - No response.

CAS 407--USE OF STANDARD COSTS FOR DIRECT MATERIAL AND DIRECT LABOR - No response. By letter of September 27, 1972, U. S. Steel refused to respond to our questionnaire concerning Standard Cost Systems. We repeated our request by letter of November 20, 1972, to U. S. Steel, but this letter was never answered; a copy of our letter is enclosed.

CAS 408--ACCOUNTING FOR COSTS OF COMPENSATED PERSONAL ABSENCE - No response.

CAS 409--DEPRECIATION OF TANGIBLE CAPITAL ASSETS - Responded to preliminary draft Standard on May 4, 1973.

CAS 410--ALLOCATION OF BUSINESS UNIT GENERAL AND ADMINISTRATIVE EXPENSE TO FINAL COST OBJECTIVES - No response.

CAS 411--ACCOUNTING FOR ACQUISITION COSTS OF MATERIAL - Responded to initial Federal Register publication by letter dated January 30, 1975.

CAS 412--COMPOSITION AND MEASUREMENT OF PENSION COST - No response.

U. S. Steel, like other companies, is also given an opportunity to comment on our proposed regulations and other information solicited by us in our work, in addition to our research on possible Cost Accounting Standards. On August 5, 1973, U. S. Steel responded to a proposal published in the Federal Register to reduce the requirement for filing Disclosure Statements from $30 million to $10 million of negotiated awards in prior years. Also, in 1974 we requested sales data from many companies for use in our study for a possible exemption from Standards based on sales. U. S. Steel participated in this study and furnished us the requested sales data.

In the few instances that U. S. Steel did provide us with their comments, we have made revisions to our material which, in our view, accommodated many of the points they raised.

With respect to violations of Standards known by the Board, we receive annual reports containing this kind of information on a calendar

year basis from all relevant Government agencies. The bulk of any violations would be included in the Department of Defense (DOD) report, since DOD reports any violation found for all contractors for which it has audit cognizance. Thus, DOD statistics include reported violations for any contractor it audits who is also performing under NASA or AEC contracts. The violations reported to us by DOD for the past two calendar years are as follows:

Calendar Year	Total	Violations of Disclosed Practices	Violations of Standards
1973	364	67	297
1974	515	92	423

DOD does not report the disposition made of the reported violations.

I trust that the above information is responsive to your request. We will be pleased to provide you with any additional information you may desire.

Sincerely yours,

Arthur Schoenhaut

Arthur Schoenhaut
Executive Secretary

Enclosure

COST ACCOUNTING STANDARDS BOARD
441 G STREET, N.W.
WASHINGTON, D.C. 20548
Telephone: (202) 386-6213

November 20, 1972

Mr. Edgar B. Speer, President
United States Steel Corporation
71 Broadway
New York, New York 10006

Dear Mr. Speer:

The purpose of this letter is to advise you of our concern that the United States Steel Corporation apparently has decided not to participate in a research questionnaire distributed by the Cost Accounting Standards Board seeking information on company practices and views on the use of standard costs in various industries.

We fully recognize that the decision as to whether or not to participate in this research effort, or for that matter, in any of the Board's studies to develop Cost Accounting Standards, rests solely with each company. In this instance, we are concerned that adequate consideration may not have been given by the U.S. Steel Corporation to the mutual advantages to be gained by its participation in this project.

The development of a Cost Accounting Standard on the subject of the use of standard costs that would properly recognize the needs of basic materials producers, among others, requires that the accounting practices and views of such manufacturing companies be considered, particularly companies such as U.S. Steel, which use standard costs extensively in their operations. Also, one of the means available to the Board and its staff to evaluate the need for any exemptions from individual standards for particular classes or categories of contractors is the research accomplished through such means as this questionnaire.

A summary of our efforts to obtain U.S. Steel's participation in this project may be of interest to you.

One hundred and nineteen companies were sent our questionnaire on Standard Costs on August 7. U.S. Steel was included in this solicitation on two counts: Mr. Ben F. Holcomb of your company requested that he receive all CASB staff research material, and U.S. Steel is known to use standard costs in its steel producing operations. The companies receiving the questionnaire were asked to submit their responses by September 15.

On September 12, Mr. Holcomb telephoned Mr. William Parker, a CASB staff Project Director, to request additional time to respond to the questionnaire beyond the due date. Mr. Holcomb explained that U.S. Steel needed additional time to be certain its response to the questionnaire explained clearly how standard costs are used by the company, particularly in its product manufacturing operations. Mr. Parker advised Mr. Holcomb that we had no objection to the requested delay.

On September 27, we received a letter from Mr. Holcomb (enclosed) stating that, "We have elected after careful deliberation not to fill out the questionnaire." The remainder of the letter advances various reasons why this decision was reached by U.S. Steel. We were somewhat puzzled by several of the reasons given by Mr. Holcomb.

For example, Mr. Holcomb states that the questionnaire is designed primarily for a contract cost accounting system and, therefore, U.S. Steel's response would be limited and would not provide us with the full story for research purposes. The questionnaire purposely was not designed for any one type of accounting system. Not one of the several professional accounting association committees, individual consultants, or Board members who reviewed the questionnaire in draft form believed that it was directed to a particular accounting system. Moreover, we have received adequate responses from a number of basic material industry companies, including three steel producers. Also, our responses to date show, as we expected, that only a very limited number of contractors who employ a contract or job order system utilize standard costs in their operations.

Mr. Holcomb's letter also cited as a reason for not responding the fact that at U.S. Steel commercial and defense materials are produced interchangeably and it is not practicable to identify or accumulate by projects or contracts. There is nothing stated or implied in the questionnaire which would indicate that we are advocating or considering a proposed Standard which would require actual cost identification of individual products, projects, or contracts.

In light of the above, Mr. Parker tried to telephone Mr. Holcomb immediately after receipt of the September 27 letter, but we learned that Mr. Holcomb would be on vacation until October 16. At my direction, Mr. Parker thereupon called Mr. Bracey Smith, Vice President and Controller

of U.S. Steel. Mr. Parker outlined our policy of attempting to obtain maximum participation from industry in our studies and said that we were somewhat concerned with U.S. Steel's reasons for deciding not to participate in this particular project. Mr. Smith agreed to look into the matter and to have someone contact us.

On October 17, Mr. Holcomb called Mr. Parker to discuss further our questionnaire on Standard Costs. Dr. David H. Li of our staff participated in this conference call. The conversation dealt primarily with Mr. Holcomb's inquiry as to the meaning of two questions and how they are related to U.S. Steel's use of standard cost. We advised Mr. Holcomb that where he believes the phraseology of any question to be unclear, he need only indicate his interpretation of the question and answer it accordingly.

The conversation ended with Mr. Holcomb's stating that he would either (1) fill out the questionnaire in preliminary form and send it to us, (2) invite us to visit in Pittsburgh and discuss this questionnaire, or (3) fill out the questionnaire and invite us to visit him and discuss U.S. Steel's response to the questionnaire. Mr. Holcomb stated that U.S. Steel's standard cost system is one of the best in the steel industry.

To date we have not had any further communication from Mr. Holcomb nor any one else at U.S. Steel.

Although a timely response to the questionnaire is no longer possible, we still believe it is important to obtain the input from U.S. Steel in our consideration of an appropriate cost accounting standard on this subject. From its earliest meetings, the Cost Accounting Standards Board determined that the establishment of Standards would be, to the extent the Board could make it so, an endeavor that would seek the cooperation of all those who would be concerned with the Standards. To this end, the Board has vigorously urged industry and others knowledgeable in the area of cost accounting to assist the Board as much as possible. I believe that those contractors who have worked with the Board's staff in the development of Standards have found us receptive in trying to understand the contractors' points of view.

It is in furtherance of this Board policy and in consideration of your company's expertise in the subject, that I am making this additional effort to solicit your aid in obtaining the cooperation of U.S. Steel.

Sincerely yours,

Arthur Schoenhaut

Arthur Schoenhaut
Executive Secretary

Enclosure

cc: Reading, Subject, Chron., Mr. Parker

WP/ap

EXHIBIT 3

UNITED STATES OF AMERICA
GENERAL SERVICES ADMINISTRATION
WASHINGTON, DC 20405

FEDERAL PREPAREDNESS AGENCY

JUL 17 1975

Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

This is in reference to your letter of July 3, 1975, discussing DPS Regulation 1, its relationship to the Defense Production Act, and requesting my views on three specific questions.

I have examined DPS Regulation 1 and the Defense Production Act to determine whether the Regulation provides a basis for a defense contractor to refuse a rated order if the order contains provisions required by law that the contractor does not choose to accept. In my view the DPS Regulation does not provide a basis for such a refusal.

There is nothing explicit in the Regulation that allows a contractor to disregard applicable regulations and statutes, nor do I find anything implicit, especially in section 18, which might afford a contractor the basis for refusing an order because it requires compliance with provisions of law the contractor dislikes.

In section 18(a) of DPS Regulation 1, the Department of Commerce is implementing sections 704 and 707 of the Defense Production Act. The former grants authority to issue rules, regulations and orders necessary or appropriate to effectuate the provisions of the Act, while the latter prohibits discrimination against priority orders or contracts by the imposition of higher prices or by imposing terms and conditions on priority orders different from those customarily accompanying non-rated comparable orders or contracts.

The reasons enumerated in section 18 why a supplier may reject a rated order are an attempt to incorporate certain trade practices and customary ways of doing business which would otherwise make acceptance of rated orders unreasonable. In my opinion, section 18 of DPS Regulation 1 was not intended to provide a legal basis for a contractor to refuse a priority order because the contract contains other required provisions of law which the contractor dislikes.

We have recently been requested to provide guidance where a defense contractor was willing to continue delivery pursuant to rated orders but did not wish to comply with cost accounting standards imposed on him under section 719 of the Act. Our opinion was that we have authority under Title I to require acceptance and performance of orders considered necessary or appropriate to promote the national defense and to take appropriate action where there is no compliance with a rated order. However, we did not view refusal to comply with cost accounting standards as a refusal to produce under a priority order. That issue thus was one for resolution between the supplier, the procuring agency, and the Cost Accounting Standards Board.

Our response in the negative to your first question makes answers to your second and third questions unnecessary. Please let me know if I can be of further assistance to you in this matter.

Sincerely,

LESLIE W. BRAY, JR.
Director

United States Senate

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

July 3, 1975

Gen. Leslie W. Bray, Jr.
Director, Office of Preparedness
General Services Administration
Washington, D. C. 20405

Dear General Bray:

As you know, the Senate Committee on Banking, Housing and Urban Affairs is holding hearings during July to consider the extension of the Defense Production Act.

As a follow-up to earlier hearings on the Defense Priorities System, I would like to deal briefly with the problem of sole-source defense contractors who refuse to accept defense orders if they are required to comply with various statutes.

You may have read some of the recent press accounts describing how a major U.S. oil company refused to provide oil to the military if the company were required to comply with the Cost Accounting Standards--something they are required by law to do. Similar situations have arisen in the case of the Truth-In-Negotiations Act.

In sole-source situations, or when all contractors in a particular industry take a unified position in opposition to these requirements, the Government ends up in the position of having to compromise its own laws or risk doing without essential military supplies. Neither alternative is acceptable.

To preclude situations where contractors refuse to provide supplies or services needed for national defense, the Defense Production Act gives the President authority to require performance of orders required for national

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defense. By Executive Order, the President's authority and responsibilities under the Act have been assigned to your office, which in turn has delegated certain administrative responsibilities to the Department of Commerce.

The Act specifically provides:

"The President is hereby authorized (1) to require that performance under contracts or orders (other than contracts of employment) which he deems necessary or appropriate to promote the national defense shall take priority over performance under any other contract or order, and, for the purpose of assuring such priority, to require acceptance and performance of such contracts or orders in preference to other contracts or orders by any person he finds to be capable of their performance, and (2) to allocate materials and facilities in such manner, upon such conditions, and to such extent as he shall deem necessary or appropriate to promote the national defense."

It further goes on to say that:

"No person shall discriminate against orders or contracts to which priority is assigned...by charging higher prices or by imposing different terms and conditions for such orders or contracts than for other generally comparable orders or contracts or in any other manner."

Moreover, the Act prescribes that criminal penalties can be levied in cases where contractors willfully violate any provision of the law or regulation.

However, it appears that in promulgating implementing regulations, the Department of Commerce has clouded the issue. DPS regulation #1, as revised, dated July 1, 1974, states under Section 18:

"A supplier may reject a rated order in the following cases...(1) if the person seeking to place the order is unwilling or unable to meet the supplier's regularly established terms of sale or payment."

Armed with that regulation, a contractor might argue that if his preferred terms and conditions of sale do not include requirements concerning Equal Employment Opportunity, Labor Standards, Renegotiation, Truth-In-Negotiations, Cost Accounting Standards, Anti-Kickback Act, and so on, then the contractor has the right to refuse the order, even when the supplies and services are essential to national defense and he is the only contractor who can provide them.

Implicit in the Government's authority to direct the acceptance and performance of defense orders is that these orders must comply with applicable laws and regulations. I find nothing in the Defense Production Act itself that would indicate to the contrary. Thus, it appears that in this regard DPS Regulation #1 goes well beyond authorities provided in the Act by establishing separate categories of Government contracts where statutory requirements need not be met. Here DPS Regulation #1 appears to vitiate the objective of the DPA, which is to obtain the performance of national defense contracts and orders.

I do not see how Congress can tolerate a situation wherein large contractors can effectively blackmail the Government on items needed for national defense, refusing to accept orders on contracts with statutory provisions which they find inconvenient. The fact that many corporations have great economic leverage in dealing with the Government should not be reason for them to be excused from complying with laws that are applied to all other defense contractors.

I realize that I am raising this issue, which came to my attention through recent hearings in the House of Representatives, rather late in terms of the July 7th hearings on the Defense Production Act. However, I feel that the matter is of such importance that we should take up this contradiction between the provisions of the Act and the implementing regulations at the earliest possible opportunity.

Therefore, I would appreciate your being prepared to respond in the hearings to the following questions:

a. Do you consider that DPS regulations allow a defense contractor to refuse acceptance of a rated purchase order on the basis that it contains provisions required by law or regulation which he does not choose to accept?

b. If the answer to (a) above is yes, how are procuring activities expected to get the supplies and services they need under the Defense Production Act and still comply with applicable procurement statutes and regulations?

c. What is the legal authority, if any, for issuing a regulation that would have the effect of excusing contractors from complying with applicable statutory requirements on rated orders?

Your consistent willingness to assist the Congress in other matters is greatly appreciated and I hope you will be able to continue helping us sort out these issues in the present case.

Sincerely,

William Proxmire
Chairman

[EXHIBIT 4]

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., March 4, 1975.

From: Commander, Naval Sea Systems Command.
To: Chief of Naval Material (MAT 021).
Subject: Request for waiver of the Cost Accounting Standards clause.
Enclosures: (1) Request for waiver of Cost Accounting Standards clause for the U.S. Steel Corporation on Electric Boat Division orders for SSN 688 and TRIDENT class submarine construction steel plate and air flasks; SUPSHIP Groton ltr ser 410–151C. (2) Supporting information for Cost Accounting Standards waiver request.

1. By enclosure (1), the Supervisor of Shipbuilding, Conversion and Repair, Groton, Connecticut, proposed that the Cost Accounting Standards Clause be waived for the U.S. Steel Corporation whose subcontracts with the Electric Boat Division of General Dynamics Corporation provide critical support for the SSN 688 and TRIDENT Class Submarine Construction Projects.

2. This Command concurs with this proposal and, in accordance with ASPR Appendix O, requests that the requirement for Cost Accounting Standards be waived on U.S. Steel subcontracts with Electric Boat for SSN 688 and TRIDENT Submarine construction contracts. Enclosure (2) is forwarded in support of this request.

3. U.S. Steel is the sole source for steel, high-pressure air flasks and the primary producer of HY–80 steel plate used in building nuclear submarines. Unless the Government grants a waiver for CAS requirements, U.S. Steel indicates that it will refuse all purchase orders for the flasks. Because these flasks are critically needed to maintain timely delivery of the SSN 688 Class submarines, an expeditious ruling on this request is urgently needed.

GERALD MCBRIDE,
Deputy Commander for Contracts (Actg).

SUPERVISOR OF SHIPBUILDING,
CONVERSION AND REPAIR, USN,
Groton, Conn., February 11, 1975.

From: Supervisor of shipbuilding, conversion and repair ,USN, Groton.
To: Commander, Naval Sea Systems Command (SEA 0222).
Subject: Request for blanket waiver of Cost Accounting Standards requirements for U.S. Steel Corporation on Electric Boat Division orders for steel plate and high pressure air flasks.
Reference: (a) NAVSEA memorandum Ser 810 of August 21, 1974, (b) SUPSHIP, Groton ltr Ser 412–1047C of July 31, 1974.
Enclosure: (1) Electric Boat Division ltr to SUPSHIP, Groton of February 5, 1975, same subject, with enclosures thereto.

1. Electric Boat Division, by enclosure (1), has requested the Contracting Officer's assistance in obtaining a Blanket Waiver of the Cost Accounting Standards (CAS) requirements for purchase orders placed with the U.S. Steel Corporation. This request follows Electric Boat Division's reopening of discussions with the U.S. Steel Corporation at the Corporate Office executive level, as suggested by reference (a), and the vendor's reaffirmation of his policy of not complying with CAS requirements, as evidenced by enclosure (2) to enclosure (1).

2. Based on the information contained in enclosure (1) and that previously furnished by reference (b), this office considers that the Contractor has taken all possible action to obtain compliance with CAS requirements for Purchase orders placed with the U.S. Steel Corporation. As indicated in enclosure (1) to reference (b), U.S. Steel is Electric Boat's sole source for timely supplies of HY–80 Steel Plate and High Pressure Air Flasks needed for both the SSN 688 Class and TRIDENT shipbuilding programs. Accordingly, this office requests NAVSEA's assistance in obtaining U.S. Steel's agreement to comply with CAS requirements. In the event that such agreement cannot be obtained, it is recommended that the Electric Boat request for a Blanket Waiver be processed through appropriate channels to the Cost Accounting Standards Board for action.

E. B. HARSHBARGER.

GENERAL DYNAMICS,
ELECTRIC BOAT DIVISION,
Groton, Conn., February 5, 1975.

Subject: Request for blanket waiver of Cost Accounting Standards requirements for U.S. Steel Corporation on Electric Boat Division orders for steel plate and high pressure air flasks.

Reference: (a) Electric Boat Division request for waiver, dated July 26, 1974. (b) SupShip letter, Ser 412–1095C, dated August 22, 1974.

Enclosures: (1) Report of trip to U.S. Steel on December 3 and 4 1974, by D. H. Painter and R. W. Hudson. (2) U.S. Steel Corporation, letter dated December 13, 1974 from H. C. Haase, Vice President. (3) Information required by DPC 122.

SUPERVISOR OF SHIPBUILDING
Conversion and Repair, USN
Groton, Conn.
Attention: Code 401.

SIR: Electric Boat Division requested the Contracting Officer's assistance in obtaining a Blanket Waiver of the Cost Accounting Standards requirements for U.S. Steel Corporation in Reference (a).

SupShip, in Reference (b), refused to support a waiver and suggested that Electric Boat Division reopen discussions with U.S. Steel Corporation at the Corporate Office executive level.

Electric Boat Division has followed SupShip's suggestion. Mr. D. H. Painter, Director of Procurement, and Mr. R. W. Hudson, Steel Buyer, visited the United States Steel Corporate Offices in Pittsburgh, Pennsylvania on December 3 and 4, 1974. The meetings on December 4 were concerned with Cost Accounting Standards and DD Form 633 requirements. The results of the meeting with U.S. Steel, Sales, Accounting, and Legal Executives are summarized in the Trip Report (See Enclosure (1)).

Subsequently, a statement of U.S. Steel's position was set forth in a letter from Mr. H. C. Haase, U.S. Steel's Vice President of Staff Services and Accounting, dated December 13, 1974 (See Enclosure (2)). In this statement, U.S. Steel states that their sales under Government Prime Contracts and Subcontracts are less than ½ of 1 percent of their total annual sales. Under these circumstances, they consider the added administrative costs to be unwarranted.

They have not accepted any contracts from Government Agencies or Government Contractors containing the Cost Accounting Standards Clause and will not accept any such orders. Therefore, your assistance in obtaining a waiver of the Cost Accounting Standards requirements is again requested.

Enclosure (3) contains basic information as required by DPC 122.

Very truly yours,

D. H. PAINTER,
Director of Procurement.

TRIP REPORT

Date of trip: December 3, 1974 and December 4, 1974.

Place visited: U.S. Steel Corporate offices, Pittsburgh, Pa.

Personnel present: December 3, 1974.

U.S. Steel—D. L. Armstrong, VP sales, Eastern Steel Div.; J. W. Seel, market manager sales, Eastern Steel Div.; H. B. Montross, Jr., assistant market manager, plate sales, Eastern Steel Div.; H. V. Joyce, assistant manager sales; J. Weafer, assistant manager sales, Boston office.

General Dynamics—Corporate Office: J. Kane, Corp. director of material; E. Gray, Corp. mgr. of procurement control.

Quincy Division: J. Gilliland, special assistant to general manager; E. Barning, manager of purchasing.

Electric Boat Division: D. Painter, director of procurement; R. Hudson, steel buyer.

Purpose of visit: To discuss forecasted steel requirements.

DISCUSSION

The meeting took place in the Eastern Sales Conference Room and Mr. Kane led the discussion. Mr. Kane outlined the corporate-wide employment and sales background and outlook for 1975 and beyond. He explained that the reason

for the meeting was our concern, especially Quincy, with availability of enough plate to satisfy our needs.

Mr. Painter discussed Electric Boat Division's position and pointed out that we had been successful in placing all 4Q74 and 1Q75 requirements and are now preparing to place 2Q75 orders. Mr. Montross pointed out that Electric Boat Division had given U.S. Steel only the unattractive carbon steel tonnage and asked if we would consider a more favorable mix in the future. Mr. Painter agreed to send U.S. Steel a copy of our 1975 carbon requirements as we now know them for U.S. Steel review and comments. U.S. Steel indicated that they were still seeking HY–80 tonnage and would quote on any HY–80 requirements.

Mr. Banning and Mr. Gilliland explained Quincy's position of not having a rating, other than their first three (3) ships, and not having sufficient supply of plate to cover their needs. They requested that U.S. Steel consider a monthly allocation to Quincy for the next few years. No final decision was made but U.S. Steel appeared reluctant to take any Quincy tonnage.

Mr. Kane showed a film of General Dynamics Division activities and then a general discussion took place. Mr. Armstrong outlined U.S. Steels position and pointed out that they sorely lacked expansion necessary to cope with today's increased demand. The meeting ended with no formal commitment from U.S. Steel to increase General Dynamics allocations, nor did they refuse to do so.

CONCLUSIONS

It was apparent that both Corporations have problems unique to the times and both are aware of and understand the other's problems. The general feeling was that U.S. Steel would be more co-operative and helpful in the future but no commitments were made by them.

COST MEETING DISCUSSIONS

Electric Boat Division and U.S. Steel people discussed several other topics as follows:

1. The coal strike has definitely curtailed operations at certain mills. At present, the plate mills are still running at full production. Some sheet mills are completely closed. A shortage of natural gas this winter would also have an adverse effect on production although many facilities are able to convert to oil.

2. Electric Boat Division requested assistance in obtaining more HY–80 barstock since U.S. Steel is sole source and is not supplying sufficient tonnage for present needs. U.S. Steel stated that this was not an attractive item as various sizes were produced at different mills and Electric Boat Division quantities were often small. It was agreed that Electric Boat Division would develop a two (2) year total requirement and submit it to U.S. Steel for review.

3. The Gary mill HY–80 production stoppage was discussed at length. U.S. Steel stated that Gary had been experiencing a multitude of problems and had been operating at a loss for some time. To recover they are discontinuing several product lines and HY–80 is especially troublesome. They advised that they were reviewing the situation again as a result of Mr. Pierce's letter to Mr. Speer. Electric Boat Division suggested that the Government might wish to buy several shipsets of wide plates (5–688 and 9 TRIDENT) at one time for delivery now and to be used on future ships. This would avoid a re-design. U.S. Steel agreed to consider this approach and Electric Boat Division agreed to develop a list of all wide plates (over 147″) currently in 688 and TRIDENT.

Personnel present: December 4, 1974.

U.S. Steel—D. Law, legal; D. Deedy, accounting; C. Ray, legal; J. Weafer, Boston sales; H. Joyce, Pittsburgh sales.

Electric Boat Division—D. Painter, director of procurement; R. Hudson, senior technician buyer.

Purpose of visit: To discuss Cost Accounting Standard and DD–633 problems.

DISCUSSIONS

(1) Cost Accounting Standards—U.S. Steel has refused to submit a disclosure statement as required by the Uniform Cost Accounting Standards Regulations

(CAS). Electric Boat Division attempted to get a waiver but SupShip, Groton, would not approve the request.

U.S. Steel advised that only ½% of their business is government related. In order to set up the necessary accounting systems they estimated it would eat up approximately 10 year's profit of government related sales. They consider this a poor business practice and will not comply. They have taken this position with all other customers, including government agencies.

They indicated a movement is taking place in Congress to relieve this requirement from producers such as U.S. Steel, who have only a small percentage of their business government related.

U.S. Steel will prepare a letter to Electric Boat Division stating their position on this matter, which will be resubmitted to SupShip, Groton with another request for waiver.

(2) DD–633—U.S. Steel had refused to submit DD–633's on air flask orders unless specifically requested by the Navy to do so. They have always submitted them to SupShip, Groton, in the past with the provision that SupShip did not disclose the information to Electric Boat Division

U.S. Steel advised that they feel that the execution of DD–633's, submitting to subsequent audits, and disputes of cost elements with the auditors to be time consuming and extensive to them, especially since they will not adjust costs regardless of audit results. They are willing to comply, however, but want SupShip to make the request just to be certain that it was truly required.

Since the question of DD–633's and Cost Accounting Standards are inter-related, U.S. Steel prefers to defer the DD–633 problem until the CAS problem is resolved.

Conclusion: U.S. Steel is firm in their position, but cooperative and sympathetic to Electric Boat Division's position. They are anxious to resolve the CAS problem and will submit any back-up data we request.

R. Hudson,
Senior Technical Buyer.
D. H. Painter,
Director of Procurement.

United States Steel Corp.,
Pittsburgh, Pa., December 13, 1974.

Electric Boat Division
General Dynamics Corp.
Groton, Conn.
Attention: Mr. Don H. Painter, Director of Procurement.

Re: Cost Accounting Standards and Cost Disclosure Statement (Form DD 633) requirements. E. B. Division-purchase order subcontracts K7039–801; K5077–771 and all negotiated subcontracts in excess of $100,000.

This letter is furnished pursuant to your company's request as made during the December 4, 1974 meeting between our respective representatives and is in reaffirmation of our position as previously stated in our letter of June 5, 1974 to your company.

Please be advised that the Cost Accounting Standards clause and the requirement for furnishing a Disclosure Statement are not acceptable to U.S. Steel Corporation in connection with the subject purchase order subcontracts or any other negotiated subcontracts in excess of $100,000.00 awarded by your company. We must decline to accept any subcontracts containing the Cost Accounting Standards and Disclosure Statement requirements and request that your company obtain a waiver as is provided in the regulations. Our reasons for our position are based on the two following factors:

(1) The administrative burden would be grossly disproportionate to the benefits which could be expected. Based on current activity levels, U.S. Steel's sales under Government contracts and subcontracts of the type which might be considered subject to these requirements represent less than one-half of 1% of our total annual sales. If forced to revise our present cost system or maintain a set of supplementary records to comply with cost accounting standards, a significant cost burden would be placed on the relatively limited products sold to the Government, directly or indirectly.

(2) Failure to grant an exemption may disrupt and may even prevent the orderly and economical acquisition on a timely basis of supplies essential to your company to meet the needs of the Government.

As further clarification of our position regarding non-acceptance of the Cost Accounting Standards clause, we have not accepted any contracts containing the Cost Accounting Standards clause and the requirement to file Cost Accounting Disclosure Statements. We have consistently taken this same position with respect to requests for inclusion of the Cost Accounting Standards clause and Disclosure Statement requirements in subcontracts placed by other customers under government prime contracts as well as under prime contracts placed directly by other Government agencies such as the Defense Construction Supply Center, Aberdeen Proving Grounds and others.

Very truly yours,

H. C. HAASE,
Vice President, Staff Services-Accounting.

Enclosure (3).

Subject: U.S. Steel Corporation, Request for waiver of Cost Accounting Standards requirements information required by DPC 122.

1. A blanket waiver is requested.

2. Current subcontracts subject to cost accounting standards are:

K–7039–801, HY–80 steel plate, TRIDENT	$141, 587. 92
K–5065–700, HY–80 steel plate, SSN 688 II	457, 954. 92
K–5056–700, Toroid ring segments, SSN 668 II	1, 019, 518. 20
K–5077–701, Air flasks, SSN 688 II	4, 581, 566. 00
K–5235–102, Air flasks, SSN 688 II	780, 494. 00

3. The proposed subcontractor unequivocally refuses to accept a contract containing Cost Accounting Standards requirements. (Ref: U.S. Steel letter, dated December 13, 1974)

4. The proposed subcontractor states they have not accepted any Prime Contracts or Subcontracts from Government Agencies or Prime Contractors containing the Cost Accounting Standards requirements.

5. No other source of supply exists to satisfy Electric Boat Division needs in a timely manner.

a. U.S. Steel is the only feasible source for High Pressure Air Flasks. Extensive investigation has failed to develop a feasible alternate source.

b. U.S. Steel is one of only three steel mills producing HY–80 Steel Plate. The others are Lukens Steel and ARMCO Steel. Bethlehem Steel is also a qualified source, but is not producing HY–80. Due to the needs of the Shipbuilding Program and the current steel shortage and allocation system, steel must be purchased from all three sources. The orders are subject to Cost Accounting Standards are those on which no other bids were received.

6. Awards to U.S. Steel in previous years have been:

1971	$2, 984, 030
1972	4, 260, 225
1973	1, 288, 859
1974 (estimated)	7, 755, 000

SUPPORTING INFORMATION FOR THE U.S. STEEL CORPORATION REQUEST FOR COST ACCOUNTING STANDARDS WAIVER

1. U.S. Steel Corporation is the primary producer of HY–80 steel and high pressure steel air flasks, basic materials in the fabrication of nuclear submarines, and a subcontractor of the Electric Boat Division of General Dynamics Corporation which is under contract with the Naval Sea Systems Command to construct SSN 688 and TRIDENT Class submarines.

2. U.S. Steel has unequivocally and repeatedly refused to accept subcontracts containing the Cost Accounting Standards Clause. The vendor claims that its Government contract business is so small, one half of one per cent of total revenues, that to set up the necessary accounting systems "would eat up approximately ten years' profit of Government related sales."

3. Because of this corporate policy, U.S. Steel has never entered into any contract with the Government or a Government prime contractor which includes the CAS clause.

4. Current subcontracts which would be subject to Cost Accounting Standards in this case are:

K-7039-801, HY-80 steel plate, TRIDENT	$141, 587. 92
K-5056-700, Toroid ring segments, SSN 668	1, 019, 518. 20
K-5065-700, HY-80 steel plate, SSN 688	457, 954. 92
K-5077-710, Air flasks, SSN 688	4, 581, 566. 00
K-5235-102, Air flasks, SSN 688	780, 494. 00
Total	6, 981, 121. 04

5. Awards to U.S. Steel in previous years have totalled:

1971	$2, 984, 030
1972	4, 260, 225
1973	1, 288, 859
1974 (estimated)	7, 755, 000

6. No other source for HY-80 steel and high pressure steel air flasks can fill Electric Boat Division's construction requirements in a timely manner. Only three companies (Lukens Steel, ARMCO Steel, and U.S. Steel) presently produce HY-80 steel, and, due to the current shipbuilding program needs, nation-wide steel shortage and allocation system, steel must be purchased from all three sources. Only U.S. Steel can produce the high pressure air flasks required for submarines.

7. A fourth HY-80 source, Bethlehem Steel, is qualified but has stopped HY-80 production. Until such time as additional sources or additional producer capabilities are developed, alternate methods of fulfilling the projects needs will not exist.

8. HY-80 steel and steel, high-pressure air flasks are infrequently manufactured, non-commercial materials demanding the highest standards of quality. As a result, other sources are reluctant to enter production and U.S. Steel is not eager to remain an active producer.

9. U.S. Steel, the sole source for the steel air flasks, has refused to accept the purchase orders for the air flasks unless the Government waives the CAS requirements. Any delay beyond mid-March 1975 in starting production on the flasks will have a direct negative impact on the timely delivery of the second flight of SSN 688 Class submarines. Accordingly, an expeditious resolution of this matter is necessary to avoid seriously damaging the construction program.

Enclosure (2).

[EXHIBIT 5]

CONTRACTS AND SUBCONTRACTS WHERE U.S. STEEL HAS ACCEPTED CAS CLAUSE

It is understood that U.S. Steel has accepted the CAS Clause in six contracts/subcontracts:

1. Contract awarded 28 September 1972. U.S. Army contract for artillery shells. Total value $7.641M. Performed at U.S. Steel's Berwick plant. Contract has been completed.

2. Subcontract awarded 13 October 1972. Prime contractor was Boeing Aerospace, Air Force contract for personnel access hatch covers for missile silos. Performed by U.S. Steel's American Bridge Division. Total value $1.955M. Subcontract was completed in October 1974.

3. Contract awarded 30 March 1973. U.S. Navy Contract for bomb bodies. Total value $53.188M. Performed at U.S. Steel's Christy Park plant. Contract has been completed.

4. Contract awarded 16 August 1973. U.S. Navy contract for antenna repairs. Total value $1.024M. Performed by U.S. Steel American Bridge Division. Contract has been completed.

5. Contract awarded 27 November 1973. Same product and plant as No. 1. Total value $6.750M. Contract has been completed.

6. Subcontract awarded 4 December 1973. Same as No. 2. Total value $1.975M. Subcontract will be completed during August 1975.

Note: Information provided by U.S. Steel Headquarters, Pittsburgh, Pa., to DoD.

[EXHIBIT 6]

DIRECT CONTACTS BETWEEN OFFICIALS OF THE U.S. NAVY AND U.S. STEEL IN CONNECTION WITH THE APPPLICATION OF CAS TO CERTAIN SUBCONTRACTS

The Navy has maintained the policy of dealing directly with the prime contractor, Electric Boat Division, General Dynamics (EB), and avoiding direct communication with the subcontractor (U.S. Steel). This policy is dictated by the terms and conditions of the contract wherein the prime contractor is responsible for the performance and legal/contractual compliances of the subcontractor. When it became apparent that EB had exhausted all efforts to obtain compliance from U.S. Steel, the following direct communications occurred between U.S. Navy officials and corporate personnel of U.S. Steel:

1. *Early April 1975.*—Phone conversation between Mr. M. G. Ward (NAVSEA Contracts Directorate) and Mr. H. C. Haase (Vice President for Staff Services and Accounting, U.S. Steel), subj: U.S. Steel compliance with CAS.

2. *August 4, 1975.*—Phone conversation between CAPT W. J. Ryan (Director of Procurement, OASN(I&L)), and Mr. Andrew Staursky (U.S. Steel Corporate Headquarters), subj: Query as to appropriate contact point in U.S. Steel for discussions concerning CAS case.

3. *August 6, 1975.*—Phone conversation between CAPT W. J. Ryan and Mr. H. Roderick (President of U.S. Steel), subj: apprise the company of circumstances confronting the Navy.

4. *August 12, 1975.*—Meeting at offices of CASB attended by the following persons Ray Ganem, Corporate Acctg., U.S. Steel; Bob Schell, Christy Park Wks., U.S. Steel; CAPT W. J. Ryan, Office of Assistant Sec. (I&L), Department of the Navy; George W. Markey, Jr., Office of the General Counsel, Department of the Navy; CAPT E. M. Peebles, TRIDENT Project, NAVSEA, Department of the Navy; CAPT T. M. Hopkins, SSN-688CL Project, NAVSEA, Department of the Navy; Bracy Smith, Vice President and Comptroller, U.S. Steel; Robert I. Watts, General Attorney, U.S. Steel; Dale R. Babione, OSD (I&L) Procurement, Department of Defense; Daniel J. Deady, Corporate Accounting, U.S. Steel; Charles A. Rea, Attorney, U.S. Steel; Arthur Schoenhaut, Executive Secretary, Cost Accounting Standards Board; William Parker, Project Director, Cost Accounting Standards Board; J. Jett McCormick, Assistant General Counsel, Cost Accounting Standards Board.

5. *August 19, 1975.*—Phone conversation between Mr. E. J. Williamson (Deputy Director of Procurement, OASN(I&L) and Mr. Bracy Smith (Vice President and Comptroller of U.S. Steel), subj: Request for information concerning purchase orders issued by EB to U.S. Steel.

DIRECT CONTACTS BETWEEN OSD OFFICIALS AND U.S. STEEL OFFICIALS

1. *August 12, 1975.*—Meeting at Offices of CAS Board attended by Mr. Dale R. Babione and several U.S. Steel officials.

2. *August 19, 1975.*—Telephone call from Mr. Dale R. Babione to Mr. B. D. Smith, Vice President and Comptroller, U.S. Steel to verify fact that U.S. Steel had agreed to accept the required CAS clauses.

EXHIBIT 7

APPLICATION OF CAS TO ELECTRIC BOAT DIVISION, GENERAL DYNAMICS SUBCONTRACTS WITH U.S. STEEL CHRONOLOGY OF EVENTS

1. 14 May 1974 - Electric Boat Division, General Dynamics (EB) letter to U.S. Steel explaining requirements of CAS and that CAS was mandatory for certain purchase orders.

2. 5 June 1974 - U.S. Steel (Richard Ray, Service Representative) letter to EB (Mr. J. E. Riordan, Chief of Procurement, Special Programs), re: P.O. K7039-801 refusing to accept CAS.

3. 26 July 1974 - EB letter to U.S. Navy Supervisor of Shipbuilding, Conversion, and Repair (SUPSHIP) Groton (Code 401) requesting CAS waiver for U.S. Steel.

4. 31 July 1974 - SUPSHIP Groton (CDR Harshberger) letter to Naval Sea Systems Command (NAVSEA) requesting waiver of CAS for U.S. Steel.

5. 19 August 1974 - Phone conversation between NAVSEA Contracts Directorate (LCDR VanNess) and Policy Branch, Naval Material Command (NAVMAT) (Mr. Adelson), re: No domestic firm to date had been granted a waiver to the filing of a disclosure statement.

6. 20 August 1974 - Phone conversation between NAVSEA Contracts Directorate (Mr. Wosciechowski) and Defense Contract Administration Services District (DCASD) Pittsburgh (Mr. Nanrey), re: U.S. Steel has not filed disclosure statement.

7. 20 August 1974 - Phone conversation between NAVSEA Contracts Directorate (LCDR VanNess) and SUPSHIP Groton (CDR Harshberger), re: SUPSHIP Groton advised to tell EB to attempt to obtain CAS compliance from U.S. Steel.

8. 22 August 1974 - SUPSHIP Groton (Mr. H. J. Dubicki) letter to EB (Mr. D. H. Painter, Director of Procurement), re: SUPSHIP Groton can not support CAS waiver request until matter has been pursued with U.S. Steel at highest levels of management.

9. 3-4 December 1974 - EB and U.S. Steel meeting at U.S. Steel Corporate Offices in Pittsburgh, PA.

10. 13 December 1974 - U.S. Steel (Mr. H. C. Haase, Vice President for Staff Services and Accounting) letter to EB (Mr. D. H. Painter), re: Detailed refusal of CAS.

11. 5 February 1975 - EB (Mr. Painter) letter to SUPSHIP Groton (Code 401), re: Requests CAS waiver for U.S. Steel and provides supporting information.

12. 11 February 1975 - SUPSHIP Groton (CDR Harshberger) letter to NAVSEA Contracts Directorate, re: Request for CAS waiver, enclosing EB letter of 5 February 1975.

13. 4 March 1975 - NAVSEA (Mr. Gerald McBride, Deputy Commander for Contracts (Acting)) letter to Policy Branch, NAVMAT, re: Request for waiver of CAS.

14. 6 March 1975 - CNM (ADM Kidd) Memorandum to Deputy Chief of Naval Material (Procurement and Production), re: Keep CNM advised of action taken on CAS waiver. CNM requests full compliance with regulations in force regarding CAS waivers.

15. 12 March 1975 - NAVMAT Policy Branch (Mr. Adelson)/ U.S. Navy Office of General Counsel (OGC) (Mr. Markey) Memorandum to NAVSEA, re: Requests answers to eight specific questions in regard to waiver request and requests past correspondence.

16. 27 March 1975 - NAVSEA Contracts Directorate (Mr. M. G. Ward) letter to NAVMAT Policy Branch, re: Response to 12 March 1975 memorandum.

17. 10 April 1975 - Status Report from NAVMAT Policy Branch (CAPT Peterson) to DCNM(P&P) (RADM Evans), re: Waiver request held pending further information from NAVSEA.

18. Early April 1975 - Phone conversation between Mr. M. G. Ward (NAVSEA Contracts Directorate) and U.S. Steel (Mr. H. C. Haase), re: U.S. Steel compliance with CAS.

19. 15 April 1975 - NAVSEA Contracts Directorate (Mr. M. G. Ward) letter to DCNM(P&P), re: Additional information on waiver request.

20. 22 April 1975 - Phone conversation between OGC (Mr. Markey) and NAVSEA Contracts Directorate (Mr. Ward), re: Request answers to 16 specific questions on waiver request.

21. 23 April 1975 - NAVSEA Contracts Directorate (Mr. Ward) memorandum to DCNM(P&P), re: Response to questions posed by OGC on 22 April 1975.

22. 22 May 1975 - NAVSEA Contracts Directorate (LT Morgan) memorandum to OGC (Mr. Markey), re: Supplementary information on waiver request.

23. 3 June 1975 - NAVMAT Memorandum to ASN(I&L), re: Forwarding of U.S. Steel CAS waiver request.

24. 16 June 1975 - ASN(I&L) Memorandum to ASD(I&L), re: Forwarding U.S. Steel CAS waiver request.

25. 15 July 1975 - ASD(I&L) letter to CAS Board forwarding U.S. Steel Case.

26. 18 July 1975 - NAVSEA Memorandum to ASN(I&L) via NAVMAT, re: Seeking assistance of Department of Commerce.

27. 23 July 1975 - CNM Endorsement on NAVSEA Memorandum of 18 July 1975.

28. 28 July 1975 - CAS Board letter denying U.S. Steel CAS waiver request.

29. 31 July 1975 - ASN(I&L) Memorandum to NAVSEA via CNM, re: Compliance with CAS.

30. 4 August 1975 - Phone conversation between CAPT W. J. Ryan (Director of Procurement, OASN(I&L)) and Mr. Andrew Staursky (U.S. Steel Corporate Headquarters), re: Query as to appropriate contact point in U.S. Steel for discussions concerning CAS case.

31. 6 August 1975 - Phone conversation between CAPT W. J. Ryan (OASN(I&L)) and Mr. H. Roderick (President, U.S. Steel), re: Apprise company of circumstances confronting the Navy.

32. 12 August 1975 - Meeting at offices of CAS Board. Attendees are listed on Attachment A.

33. 19 August 1975 - Phone conversation between Mr. E. J. Williamson (Deputy Director of Procurement, OASN(I&L) and Mr. Bracy Smith (Vice President and Comptroller, U.S. Steel), re: Request for Information concerning purchase orders issued by EB to U.S. Steel.

Ray Gnem, Corporate Acctg., U. S. Steel
Bob Schell, Christy Park Wks., U. S. Steel
Capt. W. J. Ryan, Office of Assistant Sec. (I&L), Department of the Navy
George W. Markey, Jr., Office of the General Counsel, Department of the Navy
Capt. E. M. Peebles, TRIDENT Project, NAVSEA, Department of the Navy
Capt. T. M. Hopkins, SSN 688CL Project, NAVSEA, Department of the Navy
Bracy Smith, Vice President and Comptroller, U. S. Steel
Robert L. Watts, General Attorney, U. S. Steel
Dale R. Babione, OSD (I&L) Procurement, Department of Defense
Daniel J. Deady, Corporate Accounting, U. S. Steel
Charles A. Rea, Attorney, U. S. Steel
Arthur Schoenhaut, Executive Secretary, Cost Accounting Standards Board
William Parker, Project Director, Cost Accounting Standards Board
J. Jett McCormick, Assistant General Counsel, Cost Accounting Standards Board

EXHIBIT 8

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301

INSTALLATIONS AND LOGISTICS

8 SEP 1975

Honorable William Proxmire
Vice Chairman, Joint Committee
on Defense Production
Congress of the United States
Washington, D. C. 20510

Dear Senator Proxmire:

At the hearings held on August 20, 1975 before the Joint Committee on Defense Production and the Senate Committee on Banking, Housing, and Urban Affairs, you asked that we provide an identification of any request for Cost Accounting Standard (CAS) waiver that was not submitted to the Cost Accounting Standard Board (CASB). Since the period involved extended over the past four years, which is prior to Dr. Bennett or myself taking our present positions, we agreed to submit this information for the record.

Twenty two waiver requests were received by the Office of the Secretary of Defense and subsequently returned to the Defense component without action. One of these was forwarded to the Board in error and then withdrawn, but the other cases were never submitted. All cases involved oil companies one of which was a foreign corporation. CAS did not apply to this foreign procurement. The other cases were resolved when the oil companies agreed to release sales data. This, together with other data established a market price for the supplies required and CAS was therefore not applicable to the procurement actions. We believe that the oil companies changed their position and agreed to furnish their data because of a rule change, that the Federal Energy Administration (FEA) promulgated as a result of Department of Defense action with FEA.

Sincerely yours,

Dale R. Babione

DALE R. BABIONE
Deputy Assistant Secretary
of Defense (Procurement)

EXHIBIT 9

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(INSTALLATIONS AND LOGISTICS)
WASHINGTON, D.C. 20360

29 August 1975

MEMORANDUM FOR THE DEPUTY ASSISTANT SECRETARY OF DEFENSE (PROCUREMENT)

Subj: Information for the Congressional Record

Mr. Jarrett of your staff called me this afternoon and requested that the Navy provide certain information required for insertion in the Congressional record in connection with the 20 August 1975 hearings on Cost Accounting Standards. Specifically, in lines 14 through 16 on page 79, Senator Proxmire requested that the "Committee staff be provided copies of the signed purchase orders in question when they are available."

I have contacted the ACO (SUPSHIP Groton) and determined that copies of the signed purchase orders, in their final form, are not yet available. I will provide them to you when they are available -- sometime after 8 September.

Very respectfully,

W. J. RYAN
CAPT, SC, USN

See Exhibit 23 at page 259.

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[EXHIBIT 10]

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., July 14, 1975.

Hon. ELMER B. STAATS,
Chairman, Cost Accounting Standards Board,
Washington, D.C.

DEAR MR. STAATS: Pursuant to 4 CFR 331.30 it is requested that waivers of the Cost Accounting Standards clause be approved for five subcontracts with United Steel Corporation. The attached paper provides information required under 4 CFR 331.30(c)(1) as well as a description of the procurement situation existing at this time.

We would appreciate receiving a response from the CAS Board by the end of July 1975.

Sincerely,

JOHN J. BENNETT,
Acting Assistant Secretary of Defense (Installations and Logistics).

Attachment.

In compliance with 4 CFR 331.30(c)(1), the following information is submitted:

a. *Subcontractor Refusal.* For the reasons hereinafter indicated in (h) (1) below, United States Steel Corporation has adamantly refused to accept the Cost Accounting Standards clause in a number of subcontracts involving the construction of nuclear submarines for the Naval Sea Systems Command, by General Dynamics, Electric Boat Division, as prime contractor. Pertinent details of the relevant contractual arrangements are also set forth below.

b. *Prior Acceptance of CAS Clause.* Information recently coming to our attention shows that American Bridge Division of U.S. Steel Corporation accepted prime contract N-00025-74-c-0005 dated 16 August 1973 with the CAS clause. This contract was for repair of a 1200 foot VLF antenna that was in danger of collapse. The initial award was for $439,500 and final price was $736,000.

c. *Identification of Subcontracts.* The subcontracts here involved fall into three categories.

(1) The first of these involves the following two proposed subcontracts under prime contract N00024-74-C-0206, valued at $769,923,000, for the construction of eleven SSN 688 Class submarines:

Air flasks, P.O. No. K-5077-701	$4,581,566
Air flasks, P.O. No. K-5235-102	780,494

Both of these proposed subcontracts have been unconditionally refused by United States Steel pending a satisfactory resolution of the CAS problem.

(2) The second category involves one subcontract, under the above SSN 688 prime contract, which was accepted by United States Steel on condition that a CAS waiver be obtained. This subcontract, upon which there has been some performance, is as follows:

Toroid rings, P.O. No. K-5056-700	$1,019,518

(3) The third category involves two subcontracts for HY-80 steel plate which were accepted by United States Steel on condition that a CAS waiver be obtained. One of them is under the above SSN 688 prime contract; and the other is under prime contract N00024-75-C-2014, valued at $759,200,000, for development and construction of the lead Trident submarine and two follow boats. They are identified as follows:

SSN 688, P.O. K-5065-700	$457,955
Trident, P.O. K-7039-801	141,580

The purchase order for the Trident covers only the lead submarine and is needed to supplement initial quantities of HY-80 steel plate bought under long lead time authority prior to the effective date of the Cost Accounting Standards clause and some quantity of such plate already in stock at Electric Boat. Deliveries under this purchase order were originally scheduled to commence in December, 1974. Although the plate was put into production, deliveries were not commenced until March 1975. However, all remaining steel plate for the lead submarine has now been shipped. The purchase order for the SSN 688 Class covers the full quantity of plate needed for the eleven submarines covered by the prime

contract. It is understood that plate for one and one half shipsets has been fabricated and delivered. Although the purchase order calls for deliveries of significant quantities every three to four months, with completion scheduled for November, 1977, Electric Boat does not know when United States Steel will resume deliveries.

d. *Prior Prime Contract Awards.* The totals of all Department of Defense prime contracts with United States Steel during the three prior fiscal years and for the first eight months of FY 1975 are as follows:

1972	$18, 763, 000
1973	71, 714,000
1974	15, 850, 000
1975 (first 8 months)	4, 968, 000

e. *Nonavailability of Other Sources.* No other source is available to satisfy the Government's needs on a timely basis for HY–80 steel plate. The same is true for the toroid rings and the air flasks, both of which are made from HY–80 steel.

(1) *Steel Plate.* Although both Lukens Steel Company and Armco Steel Corporation have a present capability to produce HY–80 steel, their combined capacity is only about 20% that of United States Steel. They were, nevertheless, solicited by Electric Boat for the above purchase orders but did not submit offers. It is understood that both Lukens and Armco have a backlog of rated orders for HY–80 steel to cover ship overhauls and new construction in various Navy and commercial shipyards, which will take longer than two years to fill. These orders have been placed through the Defense Industrial Supply Center and it is understood that none of them involves an amount exceeding $100,000; and, so far, the acceptance of CAS has not surfaced as an issue with either of these companies. Although the Trident carries a DX priority rating, which would come ahead of other rated orders including the DO rating applicable to the SSN 688 contract, it would not be feasible for either of these sources to fill the Trident requirements for HY–80 steel plate in the wider (147″ or wider) widths. Armco has never produced plate in the wider bands and has no facilities for such production. Although Lukens has produced plate in the wider bands, it has not done so in recent years. It has an old 186″ plant not now in use and is now interested in producing only the narrow plate. Electric Boat recently explored the possibility of obtaining wide HY–80 plate from Lukens in order to ease pressure under the Trident contract. However, this possibility was ruled out by Electric Boat because it was anticipated that use of the old plant would result in a greatly increased risk of rejection which Electric Boat was unwilling to assure because of the potential adverse impact on the Trident delivery schedule. A further complicating factor was Lukens' unwillingness to undertake this production unless it received protection from the cost impact of the increased rejection rate. Bethlehem Steel Corporation is the only other concern that has produced HY–80 steel plate, but it left the entire field of high yield steel products over eight years ago because of a number of factors including low demand and high environmental protection costs. In view of the nationwide steel shortage and allocation system, it is necessary to utilize all three of the currently availabe sources of HY–80 plate to satisfy the Navy's overall shipbuilding program.

(2) *Air Flasks.* Electric Boat has advised that the development of capability in this area would require skilled metal workers and welders, the necessary experience, and unique tooling and facilities involving a major investment. To date, only United States Steel has manufactured these flasks which are very large high pressure steel bottles made of HY–80 steel and are sub-safe components. Several companies, including Lukens, Armco, and Taylor Forge, were considered to be capable of developing flask manufacturing capability and were solicited by Electric Boat. While bomb bodies are manufactured similarly and in the past smaller flasks have been made by converting bomb bodies, flasks for the Trident and 688 submarines are much larger and have tighter specifications than any bomb ever built in any quantity. Lukens and Armco elected not to bid because of lack of interest in developing a capability. Taylor bid but its bid was 83% higher than that of United States Steel. Because of Taylor's complete lack of experience in the field and its unreasonable price, Electric Boat did not consider the Taylor bid realistic. Moreover, since both of the bids received were for prices in effect at the time of delivery, Electric Boat properly did not consider that the subcontracts awarded to United States Steel could be

considered as coming within the exception to the term "negotiated subcontract", as defined in 4 CFR 331.20(f) ; and, thus, the imposition of the Cost Accounting Standards is mandatory unless a waiver is granted.

(3) *Toroid Rings.* The toroid rings are a part of the HY–80 steel skeleton of the submarine and are used to join the cylindrical portion of the inner pressure hull to the conical portion. The production of these rings requires a large capital investment for initial manufacture and extensive machining. Only Chicago Bridge and Iron Corporation, Boston, MA., has the necessary casting facility and machining capability to make these rings. It performs this work under a second-tier subcontract with United States Steel which furnishes the required HY–80 steel. This second-tier contractor has refused to perform this work for the other producers of HY–80 steel or any organization other than United States Steel.

f. *Current Alternative Considerations.*

(1) United States Steel, because of a reduced demand in recent years coupled with environmental impact problems, has decided to cease production of wide plate at its Gary, Indiana, plant. Since it is not feasible to fill the existing Trident wide plate requirement for the two follow ships from any other source, it appears that it will be necessary to permit substitution of 112 inch HY–80 steel plate for the wide plate. Since this revision opens up the possibility of Lukens and Armco being considered as sources for this requirement, Electric Boat anticipates soliciting them along with United States Steel for this purpose. If either Lukens or Armco should receive an award, the highest (DX) priority rating assigned to the Trident will cause delayed deliveries on other orders which these concerns have already received for other priority requirements. Furthermore, it is not kown whether Lukens or Armco will be any more receptive to the Cost Accounting Standards than United States Steel. Based on past history, as recounted in h. (2) to (5) below, it would be surprising if they were. In order to meet the mandatory delivery date of April 1980, it will be necessary for all deliveries of HY–80 plate for the second submarine to be completed by early Spring 1976. The corresponding deadlines for the third submarine are eight months after those for the second submarine. In order to meet the mandatory delivery schedule for the two follow submarines, Electric Boat plans to make an award of a subcontract, following resolicitation, by August 1975. The estimated cost of this proposed procurement is $350,000.

(2) As indicated in e. (2) and e. (3) above, there appear to be no practical alternatives for meeting the current requirements of the Trident and SSN 688 contracts regarding air flasks and toroid rings.

g. *Future Procurements.* On the basis of current knowledge, the Navy has little prospect of breaking away from major reliance on United States Steel in regard to the construction of nuclear submarines and other major Naval vessels, even though it should become possible to introduce additional sources or increase procurement from existing sources for one or more of the items involved.

(1) *HY–80 Steel Plate.* There is no reasonable prospect of establishing additional sources of supply for future procurements of HY–80 steel plate. For example, Bethlehem has recently reaffirmed prior information that it is unlikely to be interested in again producing HY–80 steel plate even though it now has available a basic oxygen furnace, employing a recently developed process which would permit production of HY–80 steel within EPA standards without incurring significant additional costs. While Bethlehem indicated that year-round production of HY–80 would be profitable, the quantities covered by the Navy's anticipated annual demand would require only a few days of unprofitable production even if Bethlehem received every award. Under these circumstances, it would, of course, be untimely to attempt to ascertain Bethlehem's attitude regarding the Cost Accounting Standards. Accordingly, and notwithstanding the reduction in the mandatory width of HY–80 steel plate for the two follow boats under the Trident contract and the consequent possible consideration of Lukens and Armco for this revised requirement, primary reliance on United States Steel will still be required for major shipbuilding programs and, particularly, for those calling for tight delivery schedules, such as the Trident and the SSN 688.

(2) *Air Flasks.* Since neither Lukens nor Armco appear to be interested in producing the air flasks and, with the single exception indicated in e. (2) above, bomb body and other manufacturers have not expressed an interest, it would be unrealistic to anticipate the establishment of any additional sources of supply for this item on future procurements.

(3) *Toroid Rings.* In regard to the toroid rings, the question of obtaining this item by prime contract or direct first tier subcontract will be reexamined; however, it should be recalled that HY–80 steel from which they are manufactured will have to come from United States Steel unless Chicago Bridge and Iron Corporation can be induced to change its existing policy and Lukens or Armco is otherwise able to supply the steel.

h. *Other Background Information.*

(1) *Subcontractors Position.* The United States Steel position in refusing to accept the Cost Accounting Standards clause is stated as follows:

(a) Only ½% of its business is Government related.

(b) It presently has a very elaborate standardized corporate accounting system. The imposition of the specific Cost Accounting Standards would require possibly far-reaching changes to the accounting system, the consequences of which cannot fully be evaluated at this time. The volume of Government business does not justify the possible consequences.

(c) The law is unreasonable when applied to this business situation.

(d) This is a fully considered corporate position relative to the Cost Accounting Standards.

(2) *Noncompetitive Practices; Cease and Desist Order.* The steel industry has had a long history of noncompetitive practices, including the identical mill pricing of alloy steels. As a result, the Federal Trade Commission, on August 10, 1951, acting under the Federal Trade Commission Act, as amended (15 U.S.C. §§ 41–58), issued its "Report, Findings as to the Facts, and Order" to cease and desist from price fixing practices in a proceeding wherein American Iron and Steel Institute, the four steel companies discussed herein, and many other steel companies, as defendants, were charged with violating Section 5(a) of the Federal Trade Commission Act, as amended (15 U.S.C. Section 45(a)). The Commission's report, findings, and order (issued as a consent order), is reported in 48 F.T.C. 139, *et seq.*

(3) *Refusal to Furnish Cost or Pricing Data; 1965 GAO Report.* Since the enactment of the Truth-in-Negotiations Act (P.L. 87–653, 10 U.S.C. § 2306(f)), there has been a continuing problem involving the inability of the Navy and its prime contractors to obtain cost or pricing data from United States Steel Corporation and Lukens Steel Company, as well as other steel companies. A GAO Report to the Congress of the United States B–148772, dated June 28, 1965, OSD Case No. 2119) covered the five-year review of procurements by the Navy and its prime contractors, valued at about $106 million, in support of the construction of nuclear Submarines and other Navy vessels. The report disclosed that, on the basis of costs incurred, profits by United States Steel were 14.5 percent and by Lukens, 27 percent. The Navy's reply to this report states that it had regularly reported the pattern of identical pricing to the Department of Justice and the Federal Trade Commission. It also called attention to the fact that the Attorney General's report entitled "Identical Bidding in Public Procurement", dated July 1964, and covering calendar year 1962 purchases, reflects (in Table I, on page 13) the Federal Supply Classification Product Categories which most frequently experienced identical bidding; and the top item on the list is "Plate Sheet and Strip, Iron and Steel". The Navy noted that it was making this observation to suggest the possible need for Government-wide attention. It was also noted that, since the jurisdiction of the Department of Justice and the Federal Trade Commission overlaps to some extent in the antitrust field, it had been agreed between these agencies that the Federal Trade Commission would pursue the matter. Although the reply further stated that the Navy would make every effort to obtain certified cost or pricing data, neither the Navy nor its prime contractors have been able to obtain such data.

(4) *1972 GAO Report.* A further GAO Report (B–148722, dated July 7, 1972, OSD Case #3499), points out refusals to furnish cost or pricing data for HY–80 steel by Armco and Bethlehem as well as a continuation of the refusals by United States Steel and Lukens. It is further reported that, although mandatory orders could be issued under the Defense Production Act, neither that Act nor any other existing law compelled the furnishing of cost or pricing data to establish the reasonableness of the prices for products furnished under such orders. Attention is also called to the Navy's correspondence with the Federal Trade Commission relating to enforcement of the 1951 cease and desist order. Initially, the Commission investigation stemming from a 1964 Navy letter resulted in an opinion that there was insufficient evidence to prove a conspiracy in the submission of bids for HY–80 steel plate. However, following a further

Navy letter in 1971, the Commission reopened the matter to determine whether there had been a violation of the 1951 order.

(5) *Suit to Enforce Cease and Desist Order.* On June 18, 1974, the Federal Trade Commission instituted a suit under Section 16(b) of the Federal Trade Commission Act, as amended (15 U.S.C. § 56(b)) against both United States Steel and Lukens; and, pursuant to Sections 5(l) and 5(m) of said Act, as amended (15 U.S.C. §§ 45(l) and 45(m)), it is seeking a permanent injunction to enforce the 1951 cease and desist order and exact civil penalties, which could amount to as much as $10,000 per day, for violations of said order allegedly extending over a period of at least five years. The complaint specifically alleges that both companies, in seeking subcontracts for HY–80 and HY–100 steel plate from Newport News Shipbuilding and Dry Dock Company "employed pricing and freight factors so as to insure that their bids were identical"; and it further alleges that, "pursuant to arrangements with and cooperation of Newport", these companies were permitted to "adjust said bids up or down after original submission so as to insure price identity and maintenance and the avoidance of pricing differentials on HY–80 and HY–100". This case is currently pending in the United States District Court for the District of Columbia, as Civil Action No. 74–926.

AUGUST 1, 1975.

MEMORANDUM FOR THE ASSISTANT SECRETARY OF NAVY (INSTALLATIONS AND LOGISTICS)

Subject, Request for Waiver of Cost Accounting Standards Clause for U.S. Steel Corporation (N–75–17).

Your request for Cost Accounting Standard waiver to place five subcontracts with U.S. Steel has been denied by the Cost Accounting Standards Board. A copy of the Board's letter dated July 28, 1975 denying the waiver is attached.

Please advise us of the impact of this denial and the alternative actions the Navy is taking.

Attachment.

JOHN J. BENNETT,
Acting Assistant Secretary of Defense.

COST ACCOUNTING STANDARDS BOARD,
Washington, D.C., July 28, 1975.

Dr. JOHN J. BENNETT,
Acting Assistant Secretary of Defense (I&L), Department of Defense, Washington, D.C.

DEAR DR. BENNETT: This is in response to your letter of July 14, 1975, (N–75–17) which requested that waivers of the Cost Accounting Standards clause be approved for five subcontracts with United States Steel Corporation. The subcontracts, which are for air flasks, toroid rings and steel plate of HY–80 steel, are to be awarded under prime contracts for submarine construction placed by the U.S. Navy with the Electric Boat Division of General Dynamics Corporation.

The Board may grant exemptions and waivers to its requirements upon its determination that such exemptions and waivers are "appropriate and consistent with the purposes sought to be achieved" by Public Law 91–379. One of those purposes is "to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts." Any exemption or waiver which the Board determines to grant derogates from the purpose of consistency and uniformity. So long as waivers have been seldom sought and granted only in unusual situations, the Board's actions, while not promoting uniformity and consistency, have been appropriate to the purposes of P.L. 91–379.

To grant the waiver requested for U.S. Steel might well encourage waiver requests by others in similar situations. If the Board were to grant such waivers, that could lead to the establishment of a commercially powerful group of industries who would be sole source suppliers of essential defense products, but who would have succeeded in gaining exemption from the CAS clause. On the other hand there would also exist a substantial group of contractors, in many cases

also sole sources, who do accept the CAS requirements, to some extent because members of the latter group are dependent on Government business for continued existence. This situation would create a substantial departure from the statutory objectives of uniformity and consistency and would indicate that such waivers are not the kind contemplated by P.L. 91–379. In view of the foregoing and after considering the information furnished in support of the request for waivers for the U.S. Steel subcontracts, the Board has concluded that the request must be denied.

Sincerely yours,

ARTHUR SCHOENHAUT,
Executive Secretary.

EXHIBIT 11

DEFENSE PROCUREMENT CIRCULAR

4 MARCH 1975 NUMBER 74-5

This Defense Procurement Circular is issued by direction of the Assistant Secretary of Defense (Installations and Logistics) pursuant to the authority contained in 5 U. S. Code 301, 10 U. S. Code 2202, DOD Directive No. 4105.30, and ASPR 1-106.

All Armed Services Procurement Regulation material and other directive material published herein is effective upon receipt except as otherwise indicated.

Unless otherwise indicated in the introductory language preceding an item, each item in this Circular shall remain in effect until the effective date of that subsequent ASPR revision which incorporates the item, or until specifically canceled.

Reproduction authorized.

CONTENTS

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ITEM I -- MARGIN RULE ON REPLACEMENT PAGES

The margin rule in the right-hand margin of replacement pages indicates material which is new in this DPC and in previous DPCs published since the July 1974 Edition of ASPR.

ITEM II — MINIMUM BID ACCEPTANCE PERIOD

In order to assure that a minimum bid acceptance period is clearly specified when considered necessary, 2–201(a)Sec.C(xviii) and 2–201(b)(xii) are revised as shown on the attached replacement pages. In addition, 7–2003.26 is deleted.

Replacement pages: 2:6, 2:7, 2:11, 2:12, and 7:506

* * * * *

ITEM III — COST ACCOUNTING STANDARDS

Problems have been encountered by both Government and contractor personnel in the administration of the Cost Accounting Standards Board rules and regulations, particularly in the execution of contract adjustments required by the *Cost Accounting Standards* clause. As a result, guidance has been developed to assist operating personnel.

A new clause, "*Administration of Cost Accounting Standards*" (7–104.83(b)), has been developed for inclusion in all contracts that contain the "*Cost Accounting Standards*" clause (7–104.83(a)). The new clause prescribes procedures to be followed at both the prime contract and subcontract level, in executing contract adjustments that incorporate changes in cost accounting practices resulting from new standards, voluntary changes, and noncompliances. In addition, ASPR Section III, Part 12, has been expanded to establish internal procedures to be followed by activities in administering actions required by the clause.

Replacement pages: 3:61, 3:69, 3:177 thru 3:191, 7:127 thru 7:128-A, 7:521, 7:522, 20:26

* * * * *

ITEM IV — GOVERNMENT PROCUREMENT QUALITY ASSURANCE FOR LOW COST, COMMERCIAL OR OFF-THE-SHELF ITEMS

ASPR revisions are published to implement changes required by item XIV of DPC 74–3.

Revised pages: 1:173, 3:89, 14:1 thru 14:4, 14:8, 14:9

* * * * *

ITEM V — **PEN AND INK CHANGES**

Rights in Technical Data and Computer Software.

To conform to the changes made as a result of Item XVII of DPC 74-3:

In the following listed paragraphs, change the phrase "*Rights in Technical Data*" to "*Rights in Technical Data and Computer Software*" and change the clause dates to: 1975 MAR.

7–104.9(j) (page 7:44)
7–104.9(l) (page 7:44)
7–104.9(p) — clause paragraphs (a), (b), and (e)(2) (page 7:46)
9–503(a) (page 9:50)

* * * * *

GENERAL PROVISIONS

Part 12—Specifications, Plans, and Drawings

1-1201 General.

(a) Plans, drawings, specifications or purchase descriptions for procurements shall state only the actual minimum needs of the Government and describe the supplies and services in a manner which will encourage maximum competition and eliminate, insofar as possible, any restrictive features which might limit acceptable offers to one supplier's product, or the products of a relatively few suppliers. Items to be procured shall be described by reference to the applicable specifications or by a description containing the necessary requirements. When specifications are cited, all amendments or revisions thereof, applicable to the procurement, should be identified and the identification shall include the dates thereof. Drawings and data furnished with solicitations shall be clear and legible.

(b) Many specifications cover several grades or types, and provide for several options in methods of inspection, etc. When such specifications are used, the solicitation shall state specifically the grade, type, or method of inspection, etc., on which bids or offers are to be based.

1-1202 Mandatory Specifications.

(a) Except as provided in (b) below, the following specifications are mandatory for use by the Department of Defense in the procurement of supplies and services covered by such specifications:

(i) Federal specifications, unless determined by the Department of Defense to be inapplicable for its use;

(ii) Military specifications approved by the Department of Defense for its use; and

(iii) Industry documents adopted by the Department of Defense as listed in the Department of Defense Index of Specifications and Standards.

(b) Federal and Military specifications need not be used for the following unless required by Departmental instructions:

(i) purchase of items for authorized resale except military clothing;

(ii) purchases for construction when nationally-recognized industry and technical source specifications and standards are available (see 18-107); or

(iii) purchase of items in an amount not to exceed $10,000 (multiple small purchases of less than $10,000 of the same item shall not be made for the purpose of avoiding the use of Federal or Military specifications).

(c) Unless required by Departmental instructions, Federal and Military specifications need not be prepared for use in the below listed procurement actions; however, existing Federal and Military specifications, and adopted industry documents to the extent that they are applicable to the item or service required, shall be used for:

(i) purchase incident to research and development;

(ii) purchase of items for test or evaluation;

(iii) purchase of laboratory test equipment for use by Government laboratories;

(iv) purchase of one-time procurement items; or

(v) purchase of items—

(A) for which it is impracticable or uneconomical to prepare a specification (Repetitive use of a purchase description containing the essential characteristics of a specification will be construed as evidence of improper use of this exception.); or

(B) when the purchase involves an item which is the product of private development and the provisions of 1–304 are complied with.

(d) If it is determined, in accordance with the procedures established under the Defense Standardization Program by the Assistant Secretary of Defense (Installations and Logistics), that the specifications listed in (a) above do not meet the particular or essential needs of a bureau, service, or command, then (except as provided in (b) and (c) above) applicable amendments, revisions or new specifications (interim Federal or limited coordination Military) shall be immediately prepared and used.

(e) When a specification is found to be defective, and it is necessary to make interim corrections to the specification to effect a procurement, the activity authorizing the corrections shall take immediate action to advise the specification preparing activity of the changes required.

1–1203 Availability of Specifications, Standards, Plans and Drawings.

1–1203.1 *General.* Each solicitation shall be accompanied with the applicable specifications, standards, plans, drawings, descriptions and any other pertinent documents, or shall state where such documents may be obtained or examined, in accordance with this paragraph. In the case of specifications and drawings available from the purchasing office, the solicitation should identify as precisely as possible the responsible individual's name and title, address and room number, office symbol, and telephone number, for purposes of facilitating and expediting requirements for documents or for examination of such documents.

1–1203.2 *Specifications and Standards Listed in the DODISS and Data Item Description Listed in the TD–3.*

(a) A Department of Defense Single Stock Point (DODSSP) has been established at the Naval Publications and Forms Center in Philadelphia for unclassified Federal, Military and other specifications and standards (including commercial) listed in the Department of Defense Index of Specifications and Standards (DODISS) and data item descriptions listed in the Department of Defense Index of Data Item Descriptions (TD–3). Except as provided in (b) below, such specifications, standards, and descriptions normally will not be furnished with the solicitation; but the solicitation shall contain the provision in 7–2003.8.

(b) Specifications and Standards listed in the DODISS (excluding commercial) and Data Items listed in the TD–3 may be furnished with the solicitation when:

(i) the nature and complexity of the item are such that furnishing with the solicitation is necessary to enable prospective contractors to make a competent initial evaluation of the solicitation;

(ii) in the judgment of the contracting officer, it would be impracticable for prospective contractors to obtain the specifications, standards and descriptions from the DODSSP in time to respond to the solicitation; *e.g.*, urgency of the procurement, isolated geographical area, or other cogent reason; or

(viii) any requirement for prior testing and qualification of a product, when the item to be purchased is on a qualified products list (see Section I, Part 11);

(ix) when the contract is for the purchase of a patented item for which the Government is a licensee (1–304.3), include the provision in 7–2003.15;

(x) when shipping weights and dimensions are required to evaluate offers as to transportation costs (see 19–210), a provision substantially as in 7–2003.16 shall be included in the solicitation, except that the paragraph relating to the Government's estimated weights and dimensions may be omitted when such estimates cannot reasonably be developed and the file is documented accordingly, prior to the issuance of the solicitation. Solicitations omitting the paragraph relating to the Government's estimated weights and dimensions shall state that the failure to furnish guaranteed shipping weights and dimensions will render offers nonresponsive, unless the contracting officer determines that the shipping weights and dimensions involved would clearly not affect the standing of the bids. To aid in computing a reduction when the contractor exceeds the guaranteed maximum(s), the award document will show the weight(s) and dimensions used in the evaluation.

(xi) when a solicitation may result in an f.o.b. origin contract and the item to be purchased is new to the supply system, nonstandard, or a modification of previously shipped item such that a different freight classification may apply (*e.g.*, contains new materials, ingredients, changed weight, cube, configuration, etc.) (see 19–202(b)), insert the provision in 7–2003.17;

(xii) when bids are to be solicited f.o.b. origin only and when it is desired that a bidder be permitted to offer commercial transit credits (see 19–206(b)), insert the provision in 7–2003.18;

(xiii) when the contract is to include the clause in 7–104.70 and when it is believed that a prospective contractor is likely to include in his f.o.b. origin price a contingent amount to compensate for what may be for him an extremely unfavorable routing condition which the Government has the option to specify at the time of shipment (see 19–208.2(b)), insert a provision substantially as in 7–2003.19;

(xiv) when supplies are to be delivered outside of the United States and more than one United States port of loading meets the eligibility criteria applicable to the nature and quantity of the supplies for movement to the overseas destination (see 19–208.1(b) and 19–213.1(d)), insert the provision in 7–2003.20;

(xv) When the proposed procurement consists of a partial set-aside for LSA firms (ASPR 1–706.7 or 1–804.1) or a partial set-aside for small business firms (ASPR 1–706.6) the clause in 7–2003.21; shall be included in Section B.

SECTION C - Instructions, Conditions and Notices to Bidders.

(i) Standard Form 33A (Solicitation Instructions and Conditions); alternatively, SF 33A may be incorporated by reference to the form name, number, and edition date;

(ii) permission, if any, to submit telegraphic bids (see 2–202.2);

(iii) permission, if any, to submit alternate bids, including alternate materials or designs (see 1–1207);

(iv) if no award will be made for less than the full quantities advertised, a statement to that effect;

(v) if award is to be made by specified groups of items or in the aggregate, a statement to that effect;

(vi) bid guarantee, performance bond, and payment bond requirements, if any (see Section X, Part 1); if a bid bond or other form of bid guarantee is required, the solicitation shall include the provisions required by 10–102.4;

(vii) directions for obtaining copies of any documents, such as plans, drawings, and specifications, which have been incorporated by reference (see 1–1203);

(viii) any applicable requirements for samples or descriptive literature (see 2–202.4 and 2–202.5);

(ix) if the contract is to be conditioned on the availability of funds, include one of the clauses in 7–104.91;

(x) in accordance with 7–2003.14(a), the notice of Pre-award on Site Equal Opportunity Review set forth therein;

(xi) if the contract involves performance of services on a Government installation, the provision in 7–2003.39;

(xii) if the contract is for multi-year procurement, the provisions required by 1–322.2(c) or 1–322.7(b);

(xiii) in accordance with 6–1104, the United States-owned foreign currency provision set forth therein;

(xiv) any applicable Service Contract Act wage determinations of the Secretary of Labor (see Section XII, Part 10);

(xv) when provision for progress payments is to be included in the invitation for bids, the notice in E–504.4 and, if appropriate, the notice in E–504.3;

(xvi) description of the procedures to be followed in obtaining permission to use Government production and research property (see Section XIII, Parts 4 and 5);

(xvii) invitations for bid which will result in the placement of rated orders or Authorized Controlled Material Orders (see 1–307) shall contain the clause in 7–2003.22;

(xviii) when considered necessary to stipulate a minimum acceptance period:

(A) Insert the stipulated number of calendar days in the blank provided in the 'Offer' portion of the SF 33, strike the phrase '(60 calendar days unless a different period is inserted by the of-

feror)', and add the following at the end of the statement: '(See Section C (insert paragraph number))'.

(B) Include in Section C of the solicitation a provision substantially as follows:

MINIMUM ACCEPTANCE PERIOD (1975 MAR)

Offerors allowing less than the number of calendar days specified in the 'Offer' portion of SF 33 for acceptance by the Government will be rejected as nonresponsive.

(End of provision)

(xix) when the contract is to contain a first article approval clause, the statement required by 1–1903;

(xx) any applicable notices of small business or labor surplus area set-asides (see 1–706.6 and 1–804.2);

(xxi) the applicable small business size standard and product classification (see 1–701 and 1–703);

(xxii) in accordance with 1–1208, the Government Surplus clause in 7–104.49;

(xxiii) in accordance with 1–1208, the New Material clause in 7–104.48;

(xxiv) if the procurement is by barter, the provision in 4–503.5;

(xxv) any offer by the Government to provide Government production and research property for the performance of the contract, and any special provisions relating thereto (see Section XIII, Part 3) (see, for example, 13–202(b));

(xxvi) when clause 7–104.62 is included in the contract and Appendix I, Table 2, does not list addresses of the required special distribution recipients, the applicable names and addresses shall be included in this Section C. The purchasing office issuing the contract shall include, referencing the line item as necessary, the addresses of the status control activity/inventory manager, and, if applicable, the processing purchasing office, cited in the Military Interdepartmental Purchase Request (MIPR).

(xxvii) the provision in 7–2003.10 when a "brand name or equal" item is being procured;

(xxviii) in unusual cases, where bidders are required to have special technical qualifications due to the complexity of the equipment being purchased or for some other special reason, a statement of such qualifications;

(xxix) Reserved.

(xxx) if the contract is to contain the Safety Precautions for Ammunition and Explosives clause prescribed by 7–104.79, a specific list of any of the mandatory requirements of DOD 4145.26M which are being waived;

(xxxi) Reserved.

(xxxii) when the contract is expected to contain requirements for provisioned items, include the information prescribed in 4–302.1;

(xxxiii) for procurements involving Foreign Military Sales (FMS) or Military Assistance Program (MAP) (Grant Aid), enter the special markings, the applicable FMS country and case identifier or MAP Record Control/Program/Directive Number identifier to permit the contractor to comply with Appendix I–301 Block 16 (12);

PROCUREMENT BY FORMAL ADVERTISING

(xxxiv) Reserved;

(xxxv) Reserved;

(xxxvi) the Late Bids provision in 7–2002.2 (this replaces paragraphs 7 and 8 of SF 33A);

(xxxvii) if the contract is for supplies purchased for resale, include the clause in 7–104.88;

(xxxviii) for procurement involving Industrial Preparedness Production Planning, see 1–2206;

(xxxix) if the solicitation is to include an Industrial Preparedness Production Planning line item, the provision in 7–2003.69 will be included;

(xl) in accordance with 3–213.4, insert the Notice of Possible Standardization provision in 7–2003.38;

(xli) if international air transportation of personnel and cargo is possible during the performance of the contract, the clause in 7–104.95; and

(xlii) the Order of Precedence provision in 7–2003.41 (this replaces paragraph 19 of SF 33A);

SECTION D - Evaluation Factors for Award.

(i) a statement of the exact basis upon which bids will be evaluated and award made, to include any Government costs or expenditures (other than bid prices) to be added or deducted, or any provisions for escalation as factors for evaluation. (The amount of any royalty payable under the royalty sharing provisions of a previously accepted value engineering change proposal incorporated in the solicitation will be considered in evaluating offers when the value engineering change is one of two or more acceptable alternatives under the solicitation.) See also 1–304.3.

(ii) if the solicitation contains an economic price adjustment clause, the provision in 7–2003.23(a);

(iii) when the contracting officer determines that it is necessary to consider the advantages or disadvantages to the Government that might result from making more than one award (multiple awards) (see 2–407.5(iii)), the provision in 7–2003.23(b);

(iv) discount provisions (see 2–407.3);

(v) when bids (or proposals) are to be solicited f.o.b. origin only and when requirement exists for transit arrangements at transit point(s) in the United States (excluding Alaska and Hawaii) (see 19–206(a)), the provision in 7–2003.23(c);

(vi) to establish the means the Government will use in f.o.b. origin solicitations in applying transportation costs for evaluation (see 19–208.2(c)), the provision in 7–2003.23(d) (which may be modified to accommodate other methods of transportation);

(vii) when the exact destination is not known (see 19–208.4(a)), the provision in 7–2003.24(a);

(viii) when the exact destination is not known (see 19–208.4(a)), or when f.o.b. origin contracts may result (see 19–209), the provision in 7–2003.24(b);

(ix) when the supplies may be purchased f.o.b. origin (see 19–212), the provision in 7–2003.24(c);

cy schedules, work statements, specifications, special requirements, or other documents too lengthy to be conveniently written into the invitation proper).

.....

(b) *Construction Contracts.* For construction contracts, the invitation for bids shall contain the following information if applicable to the procurement involved (see also 16–401.2).

(i) invitation number;

(ii) name and address of issuing activity;

(iii) date of issuance;

(iv) date, hour, and place of opening. See 2–202.1 concerning bidding time. Prevailing local time shall be used. Timing by the 24–hour clock shall not be used except where customary in the industry. The exact location of the bid depository, including the room and building numbers, and a statement that handcarried bids must be deposited therein;

(v) number of pages;

(vi) requisition or other purchase authority and appropriation and accounting data;

(vii) a brief description of the work to be performed. Reference to specifications shall include identification of all amendments or revisions thereof, applicable to the procurement and dates of both the specifications and the revisions (see 1–1201). Such description shall comply with Section I, Part 12, relating to specifications;

(viii) the time of performance (see 18–105);

(ix) permission, if any, to submit telegraphic bids (see 2–202.2);

(x) permission, if any, to submit alternate bids, including alternate materials or designs (see 1–1207);

(xi) bid guarantee, performance bond, and payment bond requirements, if any (see Section X, Part 1; 16–401.2(c)(iii)(1); and 18–801). If a bid bond or other form of bid guarantee is required, follow the instructions in 10–102.4;

(xii) When considered necessary to stipulate a minimum acceptance period:

(A) Insert the stipulated number of calendar days* in the blank provided in the 'Bid' portion of SF 19, strike the phrase '(30 days unless a different period is inserted); and add the following at the end of the statement: '(See paragraph .....** of the invitation for bids)'. When SF 21 is used, insert the stipulated number of calendar days* in the blank provided on the reverse of the form, strike the phrase '(..... calendar days unless a different period be inserted by the bidder)' and add the following at the end of the statement: '(See paragraph .....** of the invitation for bids)'.

**A 30–day bid acceptance period is normal, but may be less, and in unusual circumstances a period of 60 days may be specified.*

*** Identify specific paragraph in the invitation for bids which includes the provision in (B) below.*

(B) Include a provision in the invitation for bids substantially as follows:

MINIMUM ACCEPTANCE PERIOD (1975 MAR)

Bids allowing less than the number of calendar days specified in the 'Bid' portion of SF 19 (or on the reverse of SF 21 as applicable) for acceptance by the Government will be rejected as nonresponsive.

(End of provision)

(xiii) any authorized special provisions, necessary for the particular procurement, relating to such matters as progress payments (see Appendix E, E-504), patent rights (see 18-908), liquidated damages, profit limitations, Buy American Act (see 7-2003.65), procurement by barter (see 4-503.5), etc.;

(xiv) such general contract provisions or conditions as are required by law or by this Regulation;

(xv) any applicable wage determinations of the Secretary of Labor;

(xvi) a statement of the exact basis upon which bids will be evaluated and award made; to include any Government costs or expenditures (other than bid prices) to be added or deducted, or any provision for escalation as factors for evaluation (see 18-201). (The amount of any royalty payable under the royalty sharing provisions of a previously accepted value engineering change proposal incorporated in the solicitation will be considered in evaluating offers when the value engineering change is one of two or more acceptable alternatives under the solicitation.) See also 1-304.3.

(xvii) when considered necessary by the contracting officer to prevent practices prejudicial to fair and open competition, such as improper kinds of multiple bidding, a requirement that each bidder submit with his bid an affidavit concerning his affiliation with other concerns. To accomplish the foregoing, the provision in 7-2003.12 shall be included in the invitation for bids. Failure to furnish the affidavit with the bid shall be treated as a minor informality or irregularity (see 2-405);

(xviii) directions for obtaining copies of any documents, such as plans, drawings, and specifications, as well as information as to charge, if any, to be made for drawings and specifications (see 16-401.2(c)(iii) (2)(B));

(xix) in accordance with 6-1104, the United States owned foreign currency provisions in 7-2003.62;

(xx) information regarding bidding material which shall include Instructions to Bidders, the Bid Form, the Contract Form, the General Provisions, any conditions, the specifications and drawings (see 1-1203);

(xxi) if the contract is to be conditioned on the availability of funds, a clear statement of such condition (see 1-318);

(xxii) a statement that prospective bidders may submit inquiries by writing or calling (*collect calls not accepted*). Mr. (*insert name and address; telephone area code, number, and extension*);

(xxiii) a statement that prospective bidders should indicate in the bid the address to which payment should be mailed, if such address is different from that shown for the bidder;

(xxiv) invitations for bids which will result in the placement of rated orders or Authorized Controlled Material Orders (see 1-307) shall contain the clause in 7-2003.22;

(xxv) unless exempted by 12-805 from inclusion of the Equal Opportunity clause—

(A) on the face page or cover sheet of the solicitation, the notices in 7-2003.14(b); and

(B) BUY AMERICAN CERTIFICATE

The offeror/quoter hereby certifies that each end product, except the end products listed below, is a domestic source end product (as defined in the clause entitled "Buy American Act"); and that components of unknown origin have been considered to have been mined, produced, or manufactured outside the United States.

Excluded End Products .....

Country of Origin .....

(vi) a statement requesting the prospective offeror or quoter to list the names and telephone numbers of persons authorized to conduct negotiations;

(vii) where Standard Form 33 (Solicitation, Offer, and Award) is not used, a statement that prospective offerors/quoters should indicate in the offer/quotation the address to which payment should be mailed, if such address is different from that shown for the offeror/quoter. (Contracting Officers shall include this information in all resultant contracts which are to be administered by a Defense Contract Administration Services Regional Office.);

(viii) unless exempted by 12–805 from inclusion of the Equal Opportunity clause, the provisions in 7–2003.14(b)(1), (2) and (3);

(ix) the clause in 7–2003.13 shall be included in Requests for Proposals which do not involve set-asides for labor surplus area concerns;

(x) a requirement that the proposal or quotation state the intended place of performance, including the street address, and the names and addresses of owner and operator of producing facilities, if other than offeror or quoter, when it is reasonably anticipated that such facilities will be used in the performance of the contract;

(xi) if the contract is for the Military Assistance Program, the certificate in 7–2003.50;

(xii) if the contract is a supply or service contract pursuant to the Balance of Payments Program, the certificate in 7–2003.52;

(xiii) a request that prospective offerors or quoters state whether, to their knowledge, the procurement involves the acquisition of Government production and research property, the disposal of which may be restricted by patent or other rights (see 13–307(b));

(xiv) when the delivery of technical data is required, the provision in 7–2003.66 shall be inserted;

(xv) the appropriate transportation solicitation provisions as required by 2–201(a)Sec.B(x) through (xiv);

(xvi) (A) in accordance with 3–1203(a), insert the provision in 7–2003.67(a);

(B) in accordance with 3–1204, insert the provision in 7–2003.67(b);

(C) in accordance with 3–1213(a), insert the provision in 7–2003.67(c);

(xvii) any requirement for royalty information to be furnished with the offer or quotation (see 9–110(a));

(xviii) when neither Standard Form 33 (Solicitation, Offer and Award) nor Standard Form 18 (Request for Quotations) is used, a requirement for inclusion of "county" as part of quoter's/offeror's address will be inserted;

(xix) when the contract is for the purchase of a patented item for which the Government is a licensee (1-304.3), the provision in 7-2003.15;

(xx) when the proposed procurement consists of a partial set-aside for LSA firms (ASPR 1-706.7 or 1-804.1) or a partial set-aside for small business firms (ASPR 1-706.6), the clause in 7-2003.21 shall be included.

SECTION C Instructions, Conditions and Notices to Offerors/Quoters

(i) when Standard Form 33 is used, it shall be accompanied by Standard Form 33A (Solicitation Instructions and Conditions); alternatively, SF33A may be incorporated by reference to the form name, number and edition date;

(ii) type of contract contemplated, together with type of repricing, and economic price adjustment, if any;

(iii) when telegraphic offers are authorized, a provision similar to that in 7-2003.29;

(iv) permission, if any, to submit alternate offers, including alternate materials or designs (see 1-1207);

(v) if no award will be made for less than the full quantities solicited, a statement to that effect;

(vi) if award is to be made by specified groups of items or in the aggregate, a statement to that effect;

(vii) bid guarantee, performance bond and payment bond requirements, if any (see Section X, Part 1). If a bid bond or other form of bid guarantee is required, the solicitation shall include the provision in 7-2003.25;

(viii) directions for obtaining copies of any documents, such as plans, drawings and specifications, which have been incorporated by reference (see 1-1203);

(ix) information as to requirements for a Certificate of Current Cost or Pricing Data (see 3-807);

(x) any requirements for samples or descriptive literature (for definitions, see 2-202.4 and 2-202.5(a), respectively);

(xi) if the contract is to be conditioned on the availability of funds, include one of the clauses in 7-104.91;

(xii) when Standard Form 33 is not used, consistent with 3-805.1(a)(v) notice to all offerors that award may be made without discussion of proposals;

(xiii) if the contract involves performance of services on a Government installation, the provision in 7-2003.39;

(xiv) if the contract is for multi-year procurement, the provisions required by 1-322.2(c)or 1-322.7(b);

(xv) in accordance with 6-1104, the United States-owned foreign currency provision in 7-2003.62;

(xvi) any progress payments provisions (see Appendix E);

(xvii) any applicable Service Contract Act wage determinations of the Secretary of Labor (see Section XII, Part 10);

(xviii) solicitations which will result in the placement of rated orders or Authorized Controlled Material Orders (see 1-307) shall contain the clause in 7-2003.22;

(xxxviii) unless exempted by 12-805 from inclusion of the Equal Opportunity clause—

(A) on the face or cover sheet of the solicitation, the Affirmative Action and Nonsegregated Facilities notices in 7-2003.14(b); and

(B) the applicable Equal Opportunity Notices and Certification provisions in 7-2003.14(b);

(xxxix) the applicable small business size standard (see 1-701 and 1-703); pending revision of the October 1969 edition of Standard Form 19B, Representations and Certifications, substitute $5,000,000 for $7,500,000 in paragraph 1 when the procurement is for dredging;

(xl) in accordance with 1-332, the appropriate clause(s) on Minority Business Enterprises (see 7-104.36(a));

(xli) if pursuant to 1-1504(c), (d) or (e), options are to be evaluated for award, the applicable Evaluation of Options provision shall be inserted;

(xlii) Reserved;

(xliii) any requirement for royalty information to be furnished with the offer, proposal or quotation (see 9-110(a));

(xliv) when the contract is for the purchase of a patented item for which the Government is a licensee (1-304.3), include the provision in 7-2003.15;

(xlv) a statement on the first sheet or on a cover sheet of the Request for Proposals that:

PROPOSALS MUST SET FORTH FULL, ACCURATE, AND COMPLETE INFORMATION AS REQUIRED BY THIS REQUEST FOR PROPOSAL (INCLUDING ATTACHMENTS). THE PENALTY FOR MAKING FALSE STATEMENTS IN PROPOSALS IS PRESCRIBED IN 18 U.S.C. 1001.

(xlvi) a statement of arangements to be made for inspecting the site, including designation of the person or persons, if any, with whom such arrangements may be made and who will answer questions or furnish information;

(xlvii) information which may affect performance of the work such as boring samples, original boring logs, etc.;

(xlviii) information as to what utilities the Government will furnish during construction, when the contracting officer determines that any new utilities are adequate for the needs of both the Government and the contractor (See 7-603.30.);

(xlix) Reserved;

(l) Reserved;

(li) (A) in accordance with 3-1203(a), insert the provision in 7-2003.67(a);

(B) in accordance with 3-1204, insert the provision in 7-2003.67(b);

(C) in accordance with 3-1213(a), insert the provision in 7-2003.67(c);

(lii) the Late Technical Proposals provision in 7-2002.3, or the Late Proposals provision in 7-2002.4, (these replace paragraphs 7 and 8 of SF 22);

(liii) if international air transportation of personnel and cargo is possible during performance of the contract, the clause in 7-104.95.

(liv) the Contingent Fee provision in 7-2002.1 shall be substituted for paragraph 2 of SF 19-B;

(d) Oral solicitations shall be in accordance with the following:

(i) Oral solicitations are authorized for small purchases (see Section III Part 6, and for the procurement of perishable subsistence.

(ii) Oral solicitations, other than those described in (i) above, also are authorized in cases where the processing of a written solicitation would delay the furnishing of the supplies or services to the detriment of the Government. Examples of such circumstances may include those listed in 3–202.2. However, oral solicitation is not to be considered justified solely because a high Issue Priority Designator has been assigned to the requirement. In addition to other applicable documentation requirements (see 1–308), the record of contract actions above shall include a resume of the circumstances which justified use of an oral solicitation, item description, quantity, deliveries required, sources solicited, prices quoted (including name of individual contacted), date and time contacted, and the solicitation number (see 20–203) provided the prospective sources. Should the issuance of the resulting contractual instrument be unduly delayed, the contract file shall be documented to describe the reasons for the delay and justify award based upon the oral solicitation.

(iii) Use of oral solicitation does not relieve the contracting officer from complying with other applicable portions of this Regulation, *e.g.*, the appropriate requirements of (b) above, post-award notice of offerors (see 3–508.3), price negotiation policies and techniques (see Section III, Part 8), and submission of same terms and conditions to all offerors.

3–502 Solicitation for Informational or Planning Purposes. See 1–309.

3–503 Bidders Mailing Lists. Bidders mailing lists for negotiated procurements shall be established, maintained, and utilized in accordance with 2–205.

3–504 Pre-proposal Conferences.

3–504.1 *General.*

(a) The pre-proposal conference is a procedure which may be used, generally in complex negotiated procurements, as a means of briefing prospective offerors after a solicitation has been issued but before offers or proposals are prepared.

(b) Such a conference permits the Government to explain or clarify complicated specifications and requirements to interested firms. It may also be used to provide an opportunity for interested firms to examine a model of the equipment being procured, where for reasons such as security or limited quantities, such model can only be shown at a specific time and location.

3–504.2 *Procedure.*

(a) Where it is determined to be in the best interests of the Government to hold a pre-proposal conference, the contracting officer shall make the necessary arrangements and shall notify all those to whom solicitations have been issued as to the time, place, and general nature of the proposed conference. Such a determination may be made as a result of questions and problems raised by prospective offerors. Adequate notice shall be given to prospective offerors so that all who wish to may arrange for representation. The notice shall define as explicitly as possible the nature and scope of the conference. If time permits, prospective of-

(ii) Standard Form 36 (Continuation Sheet) provides additional space or a blank sheet of paper may be used;

(iii) DD Form 1155c-1 (Commissary Continuation Sheet) (for use on optional basis), provides columns suited for commissary procurements; and

(iv) Standard Form 30 (Amendment of Solicitation/Modification of Contract) shall be used in all modifications to DD Form 1155 (see 3-608.4).

The foregoing forms may be used as snap-out manifold forms, as cut sheets, or as reproducible masters. In addition, DD Form 1155r or DD Form 1155r-1 may be printed on the reverse of DD Form 1155.

(b) *Conditions for Use.*

(1) *Use as a Purchase Order of Not More Than $2,500 in the United States, its Possessions, and Puerto Rico.* DD Form 1155 is authorized for negotiated purchases of not more than $2,500 within the United States, its possessions, and Puerto Rico, *provided:*

(i) The procurement is unclassified, except that DD Form 1155 may be used for classified procurements if:

(A) the Military Security Requirements clause in 7-104.12 is inserted in the Schedule;

(B) DD Form 254 (Contract Security Classification Specification) (see 16-811) is incorporated in the purchase order; and

(C) the contractor's acceptance of the purchase order is obtained by use of DD Form 1155r at the time of issuance of the order.

(ii) No clause covering the subject matter of any clause set forth in this Regulation, other than clauses set forth on DD Form 1155r and clauses referred to in (iii) through (xviii) below, in 3-608.3, 3-608.4, 14-302, 14-303, 14-304, and 14-306(c) are to be used.

(iii) When the contract specifies the delivery of data, the clauses in 7-104.9 shall be added as appropriate in accordance with the instructions contained in Section IX, Parts 2, 5, or 6.

(iv) When required by Section VI, Part 4, the clause set forth in 6-403 shall be added.

(v) When required, the Extent of Quantity Variation clause set forth in 1-325 shall be added.

(vi) When required by Section IV, Part 6, Humane Slaughter of Livestock, the procedures set forth in 4-604 shall be followed.

(vii) The Material Inspection and Receiving Report (MIRR) clause shall be inserted in the Schedule as provided by 7-104.62 when the purchase is to be assigned to another activity for administration. The clause may also be inserted when otherwise desired by the purchase office.

(viii) When Government property having an acquisition cost in excess of $25,000 is to be furnished (for use in performance of contract or for repair), the appropriate Government Property clause or clauses in 7-104.24 shall be inserted in the Schedule. When Government property having an acquisition cost not in excess of $25,000 is to be

furnished for use in performance of the contract or for repair, the Government-Furnished Property (Short Form) clause in 7-104.24(f) shall be inserted in the Schedule; *provided* that use of the clause shall be optional when the acquisition cost of property furnished for repair is not in excess of $2,500. When a Government Property clause is inserted in the Schedule, the contractor's signature shall be obtained on DD Form 1155r.

(ix) When the contract is for Military Assistance Program items, the "United States Products (Military Assistance Program)" certificate and clause (see 6-703.3 and 6-703.4) shall be inserted in the Schedule, and Clause 6 of the General Provisions (Foreign Supplies) deleted. In addition, the contractor's signature shall be obtained on DD Form 1155r.

(x) When more than standard commercial preservation, packaging, packing and marking is required, the appropriate clause in 7-104.67 may be used.

(xi) The clauses in 7-104.48 and 7-104.49 may be used in accordance with the provisions of 1-1208.

(xii) When the contract is for mortuary services:

(A) the following clauses shall be inserted in the Schedule—

(I) the Specification clause in 7-1201.4;

(II) the Delivery and Performance clause in 7-1201.7;

(III) the Subcontracting clause in 7-1201.8;

(IV) the Inspection clause in 7-1902.4;

(V) the Professional Requirements clause in 7-1201.11;

(VI) the Facility Requirements clause in 7-1201.12; and

(VII) the Preparation History clause in 7-1201.13;

(B) the Additional Default Provision clause in 7-1201.9 shall be inserted in the Schedule, with the following substitution for paragraph (a) and the first sentence of paragraph (b) of that clause:

(a) This clause supplements the "Termination for Default" clause of this contract.

(b) This contract may be terminated for default by written notice if during the performance of this contract:

(C) The Changes clause in 7-1902.2 shall be substituted for paragraph 17 of the Additional General Provisions on DD Form 1155r.

(xiii) When required by Section VI, Part 8, the clause in 7-2003.53 shall be added.

(xiv) When required by Section I, Part 3, the clause in 7-104.59 shall be added.

(xv) When required by Section XII, Part 10, the clause in 7-1903.41(b) shall be added.

(xvi) When required by 19-213.2, the clause in 7-104.74 shall be added.

(xvii) In accordance with 1-330, the clause in 7-104.45(a) or 7-1912 may be inserted.

PROCUREMENT BY NEGOTIATION

Part 12—Cost Accounting Standards

3–1200 Cost Accounting Standards.

3–1201 General. Public Law 91–379, 50 U.S.C. App. 2168, as implemented by the Cost Accounting Standards Board (see Appendix 0) requires the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts and disclosure of cost accounting practices to be used in such contracts.

3–1202 Definitions. When used in this Part, the words and terms defined in Appendix 0 shall have the meanings set forth therein. In addition, the words and terms defined in this paragraph shall have the meanings set forth below:

(i) "*Net awards*" means the obligated value of negotiated national defense prime contracts, awarded in the reporting period, minus cancellations, terminations, and other credit transactions relating thereto.

(ii) "*Company*" includes all divisions, subsidiaries, and affiliates of the contractor under common control.

3–1203 Prime Contractor Disclosure Statement(s).

(a) *Solicitation Notice.* The notice entitled Disclosure Statement—Cost Accounting Practices and Certification in 7–2003.67(a) shall be inserted in all solicitations which are likely to result in a negotiated contract exceeding $100,000, except when the price is (i) based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or (ii) set by law or regulation. The notice shall not be inserted if the method of procurement utilized is:

(1) Small Business Restricted Advertising (1–706.5(b) or 1–706.7(c)).

(2) Partial Small Business Set-Aside (1–706.6).

(3) Labor Surplus Area Set-Aside (See 1–804).

The notice should also be excluded from solicitations sent to the Canadian Commercial Corporation, or solicitations which will result in contracts executed and performed in their entirety outside the United States, its territories and possessions.

(b) *Pre-Award Submission of Disclosure Statement(s).* Each offeror submitting an offer which could result in a negotiated contract exceeding $100,000 shall furnish copies of his Disclosure Statement(s) to the offices listed in paragraph (c) below concurrently with the submission of his proposal to the PCO except when the offeror has executed the Certificate of Monetary Exemption or the Certificate of Previously Submitted Disclosure Statement (see 7–2003.67(a)). More than one Disclosure Statement may be required in connection with the award of a contract (see paragraph 351.40(a) of Appendix 0). Award of a contract shall not be made until a determination has been made by the cognizant ACO that a Disclosure Statement is adequate (see 3–1205(b)) unless, in order to protect the interests of the Government, the PCO waives this requirement. In this event, a determination shall be made as soon after award as possible.

(c) *Distribution of Disclosure Statement(s).* The offeror shall distribute his Disclosure Statement(s) as follows:

(i) Original and one copy to the cognizant Contract Administration Office (Attn: ACO) (see DoD Directory of Contract Administration Components DoD 4105.59H) unless otherwise specified in accordance with 3–1208(c);

(ii) one copy to the cognizant contract auditor; and

(iii) one copy to the Cost Accounting Standards Board, 441 G Street, N.W., Washington, D. C. 20548, within 10 days after the determination of adequacy pursuant to 3–1205(b).

(d) *Post-Award Submission of Disclosure Statement(s)*. Post-award submission of Disclosure Statement(s) may be authorized only when the PCO has made a written determination that such authorization is essential (i) to the national defense, (ii) because of the public exigency, or (iii) to avoid undue hardship. Each determination shall set forth facts which clearly support the determination to authorize post-award submission, and a copy of the determination shall be included in the contract file. Authorization issued pursuant to this paragraph shall specify the period of time, not to exceed 90 days after contract award, within which disclosure must be made.

(e) *Determination of Secretary That It Is Impractical To Secure Disclosure Statement(s)*. If the Assistant Secretary (Installations and Logistics) for a Military Department or the Director for the Defense Supply Agency, the Defense Communications Agency, the Defense Nuclear Agency, or the Defense Mapping Agency determines that it is impractical to secure the Disclosure Statement(s) in accordance with the clause in 7–104.83(a) and this Part, he may authorize award of such contract without obtaining such Statement(s). This authority shall not be delegated. He shall, within 30 days thereafter, submit a report to the Cost Accounting Standards Board, setting forth all material facts.

(f) *Privileged and Confidential Information in Disclosure Statement(s)*. If the offeror or contractor notifies the contracting officer that the Disclosure Statement contains trade secrets and commercial or financial information which is privileged and confidential, the Disclosure Statement will be protected and will not be released outside the Government (see paragraph (a)(1) of the Cost Accounting Standards clause in 7–104.83(a)).

(g) *Amendment of Disclosure Statements*. Amendments of a Disclosure Statement after contract award shall be processed in accordance with paragraph 351.120 of Appendix O, 3–1205(d), and 3–1207.

3–1204 Contract Clauses.

(a) The clauses in 7–104.83 shall be inserted in all negotiated contracts exceeding $100,000, except when the price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public or is set by law or regulation. In addition to the foregoing exceptions, the clause shall not be included in the following contracts:

(i) contracts awarded pursuant to Small Business Restricted Advertising (see 1–706.5(b) and 1–706.7(c));

(ii) contracts awarded pursuant to Partial Small Business Set-Aside (see 1–706.6);

(iii) contracts awarded pursuant to the authority of Section 8(a) of the Small Business Act (15 U.S.C. 637(a) (see 1–705.5));

(iv) contracts awarded pursuant to the Labor Surplus Area Set-Aside Procedure (1-804);

(v) contracts for which the Cost Accounting Standards Board has approved a waiver or exemption pursuant to Paragraph 331.30 of Appendix O; or

(vi) contracts which are executed and performed in their entirety outside the United States, its territories and possessions.

(b) Consistent with (v) above, the Cost Accounting Standards Board has provided for the exemption of contracts of $500,000 or less under certain circumstances. Section 331.30(b)(8) of Appendix O prescribes the circumstances under which such an exemption is applicable. In order to effectively administer the requirements of that Section, the solicitation notice in 7-2003.67(b) shall be inserted in all solicitations requiring the inclusion of the solicitation notice in 7-2003.67(a).

3-1205 Review of Prime Contractor Disclosure Statements and Changed Practices.

(a) *ACO and Auditor Support Responsibility.* When DoD has contract administration cognizance of a contractor, required Disclosure Statements will be reviewed by the cognizant ACO and auditor for all Government agencies including, but not limited to, DoD, NASA, AEC, and GSA.

(b) *Determination of Adequacy.* The cognizant contract auditor shall perform an initial review of a Disclosure Statement to ascertain whether it adequately describes the offeror's cost accounting practices. In order to be deemed adequate, the Disclosure Statement must be current, accurate, and complete. Upon completion of this initial review the results shall be reported to the ACO. When the ACO determines that adequate disclosure has not been made, he shall identify the areas of inadequacy and request a revised Statement and so advise the auditor and PCO. When the ACO determines that the Disclosure Statement is adequate, he shall notify the offeror in writing with a copy to the auditor and the PCO. Notification of adequacy or inadequacy shall normally be made within 30 days after receipt of a Disclosure Statement by the ACO. In addition, the notice shall state that a disclosed practice shall not, by virtue of such disclosure, be deemed to be a proper, approved, or agreed to practice for pricing proposals or accumulating and reporting contract performance cost data. The contract may be awarded when it is determined that an adequate disclosure has been made (see 3-1203(b)).

(c) *Determination of Compliance.* Subsequent to the issuance of the above notification, a more detailed review of the Disclosure Statement shall be made by the auditor to ascertain whether the disclosed practices are in compliance with Cost Accounting Standards and, for DoD procurements, with Section XV; the auditor shall advise the ACO of his findings. The ACO shall take action regarding noncompliance with Cost Accounting Standards in accordance with 3-1212. A revised Disclosure Statement may be required. In addition, adjustment of the prime contract price or cost allowance in accordance with 3-1207(b) may be required. Noncompliance with Section XV shall be processed separately in accordance with normal administrative practices.

(d) *Review of Changed Practices.*

(1) When a change to disclosed practices is proposed or required, a description of the changed practices shall be distributed in accordance with 3-1203(c). The cognizant contract auditor shall review the changed practices for adequacy and compliance (as defined in (b) and (c) above) concurrently. Upon completion of the review, the results shall be reported to the ACO. When the ACO determines that the changed practices are adequate and in compliance, he shall so notify the contractor with a copy to the auditor.

(2) When the ACO determines that the description of the changed practices is not adequate, or the changed practices are not in compliance, he shall identify the deficiencies and so notify the contractor with a copy to the auditor. This notice shall require the contractor to advise the ACO and the auditor of the corrective action that has been taken or is to be taken. Resubmission of the changed practices will be required. In the event the contractor has submitted an adequate description of the changed practices but these practices are determined to be in noncompliance and the contractor does not agree, the ACO shall issue an adequacy determination with the stipulation that if those changed practices are implemented for the purpose of pricing or costing Government contracts, the contractor shall be considered in noncompliance and the ACO shall take action in accordance with 3-1212.

(3) When a change to established (nondisclosed) practices is proposed or required, it shall be processed in accordance with (1) and (2) above except that no submission is required to be made to the Cost Accounting Standards Board.

3-1206 Subcontractor Disclosure Statements.

(a) Disclosure Statements furnished by a subcontractor pursuant to the Cost Accounting Standards clause, should, except as provided in (b) or (c) below, be submitted to the prime contractor or higher tier subcontractor.

(b) A subcontractor may satisfy the requirement to submit Disclosure Statement(s) by identifying to the prime contractor or higher tier subcontractor the ACO to whom his Disclosure Statement was previously submitted.

(c) When a subcontractor considers that his Disclosure Statement contains information that is privileged and confidential, he may, with the approval of the prime contractor, submit it direct to the ACO and auditor having cognizance of the prime contractor's facility. The prime contractor ACO shall furnish copies to the ACO and auditor cognizant of the subcontractor for use in administration of the Cost Accounting Standards Clause.

(d) Post-award submission of the subcontractor's Disclosure Statement (see 3-1203(d)) must be approved by the ACO having cognizance of the prime contractor.

(e) A determination that it is impractical to secure a subcontractor's Disclosure Statement must be made in accordance with 3-1203(e).

3-1207 Contract Price Adjustments.

(a) *Modifications to Disclosure Statements or Established Practices.* Paragraph (a)(4) of the Cost Accounting Standards clause (7-104.83(a)) provides for adjustment of contract price under certain circumstances. The cognizant ACO is responsible for obtaining the contractor's cost impact proposal and for the conduct of all negotiations of such adjustments to all Government prime contracts.

(b) *Failure to Comply With Cost Accounting Standards Clause.* Paragraph (a)(5) of the Cost Accounting Standards clause (ASPR 7–104.83(a)) provides for an adjustment of the prime contract price or cost allowance, as appropriate, if the contractor or a subcontractor fails to comply with an applicable cost accounting standard or fails to follow any disclosed accounting practice and such failure results in any increased cost paid by the Government. The cognizant contract auditor shall be responsible for the conduct of audits as necessary to disclose such failures. The cognizant ACO shall negotiate all resultant prime contract adjustments, including applicable interest.

(c) *Conduct of Negotiations and Execution of Supplemental Agreements.* The cognizant ACO shall require the contractor to include in the cost impact proposal, proposals for adjustment to subcontracts containing the Cost Accounting Standards clause. Negotiations pursuant to (a) and (b) above shall be conducted on behalf of all Government agencies including, but not limited to, DoD, NASA, AEC, and GSA. As part of these negotiations the ACO shall also determine the effect of the change in accounting practices on each subcontract being performed by the contractor and containing the Cost Accounting Standards clause. The ACO shall invite purchasing offices to participate in negotiations of adjustments when the price of any of their contracts will be increased or decreased by $10,000 or more. At the conclusion of negotiations the following actions shall be taken by the ACO:

(i) Execute supplemental agreements to DoD prime contracts. If additional funds are required, request them from the appropriate PCO.

(ii) Prepare a negotiation memorandum in accordance with 3–811. This negotiation memorandum is of particular importance in that it will be used in reviewing the effectiveness of Cost Accounting Standards, Rules and Regulations. Copies of the memorandum shall be furnished to cognizant auditors and contracting officers of other agencies which have prime contracts affected by the negotiation. Such other agencies shall execute supplemental agreements in the amounts negotiated.

3–1208 Assignment of Contract Administration Responsibility.

(a) When DoD has contract administration cognizance of a contractor facility, the Administrative Contracting Officer (ACO) cognizant of the facility shall be responsible for performance of the functions in 1–406(c)(lix) through (lxii) notwithstanding retention of responsibility by the purchasing office for administration of the contract or specific functions thereunder (see Section XX, Part 7). The cognizant ACO shall perform the functions cited above in 1–406(c) for DoD and all other Government agencies having contracts at that facility (NASA, AEC, GSA, etc.).

(b) When a purchasing office retains responsibility for administration of a contract containing the Cost Accounting Standards clause (7–104.83(a)), the procuring contracting officer shall forward one copy of the contract to the contract administration office cognizant of the contractor's facility (see DoD 4105.59H). The following notation will be inserted in bold print on the face of the contract:

"FOR COST ACCOUNTING STANDARDS ADMINISTRATION ONLY"

(c) in some instances the contracting officer cognizant of a contractor facility will be the representative of a Government agency other than DoD. A list of such assignments will be published from time to time in Defense Procurement Circulars. When prime contract awards are to be made to such contractors, Item 1 of the solicitation provision in 7–2003.67(a) shall be modified by deleting the words "see DoD Directory of Contract Administration Components (DoD 4105.59H)" and inserting the appropriate address. The PCO shall assure that when a contract containing the Cost Accounting Standards clause (7–104.83(a)) is awarded to a contractor whose facility is under the cognizance of a non-DoD organization, that a copy of such contract, stamped as indicated in (b) above, is forwarded to the contract administration office of the cognizant agency if the contract is not assigned for field administration. That contracting officer will perform the functions in 1–406(c)(lix) through (lxii) for DoD.

3–1209 Additional Documentation. The ACO shall prepare a memorandum indicating action taken on advisory audit reports which do not result in contract price adjustments.

3–1210 Cost Accounting Standards Board Report.

(a) An annual report is required to be furnished to the Cost Accounting Standards Board (CASB) by the DoD and other Government agencies within 120 days after the close of each calendar year to provide the CASB with information to assess the effectiveness of the CASB publications and to reveal problem areas requiring new or revised Standards, Rules, and Regulations. The DoD report will include information for all affected contracts, including other Federal agencies' contracts, for which DoD has cognizance. The first report will cover the six-month period ending December 31, 1972. Subsequent reports will cover the full calendar year. RCS DD-I&L(A)1222 is assigned to this reporting requirement.

(b) Each affected Contract Administration Office and Defense Contract Audit Agency (DCAA) activity shall collect and report the information outlined in (c) below. Comments requested in (c)(8) should also be furnished by purchasing activities. Each Military Department and affected Defense agency shall review reports originating within their Departments and forward a consolidated report to OASD(I&L)(PP) within 60 days following the end of each calendar year. DCAA activities will only report items as noted in (c)(5) below.

(c) Information to be Included in the Report to the CASB.

(1) *Disclosure Statement Reviews for Adequacy*

	Initial Submissions	Submissions Due to Changed Practices
Number of statements reviewed:	_____	_____
Number of statements returned to contractors due to inadequacy:	_____	_____
Number of inadequate entries for each statement item:		
Item Number	_____	_____
Item Number	_____	_____
(*continue as required*)		

PROCUREMENT BY NEGOTIATION

This portion of the report is intended to show the number of Disclosure Statements from prime contracts that have been reviewed by the cognizant ACO and the number that were found to be inadequate and returned to the contractor. Resubmissions will not be counted. Informal discussions with contractors concerning their Disclosure Statements and voluntary corrections furnished by contractors shall not be reported.

(2) *Noncompliance with Disclosed Practices and Standards.* Number of Noncompliance Determinations Issued During the Year.

Preaward	.....
Performance	.....
Total	.....

Noncompliances reported will include only those cases where the prime or subcontractor has been formally notified by the ACO. Each formal determination of noncompliance will be counted only once irrespective of the number of disclosed practices or Standards involved. If a formal determination of noncompliance involves one or more contracts or proposals, the determination shall be reported only once. A determination which involves both proposals and performance on existing contracts or disclosed practices and performance on existing contracts shall be reported as a performance determination only.

(3) *Number of Disclosed Practices and Cost Accounting Standards Involved in the Noncompliance Determinations Issued During the Year.*

	Preaward	Performance
Disclosed Practices		
Item No.	_____	_____
Item No.	_____	_____
(*Continue as required*)		
Total Number of Disclosed Practices Involved	_____	_____
Less: Number Also Involving Standards	_____	_____
Total Number Involving Disclosed Practices Only	_____	_____
Cost Accounting Standards		
4 CFR 401	_____	_____
4 CFR 402	_____	_____
4 CFR 403	_____	_____
4 CFR 404	_____	_____
4 CFR 405	_____	_____
4 CFR 406	_____	_____
4 CFR 407	_____	_____
(Other Standards when issued)	_____	_____
Total Number of Cost Accounting Standards Involved	_____	_____

This part of the report will give a numeric count of the disclosed practices and Cost Accounting Standards by Disclosure Statement item number and Standard, respectively, involved in the noncompliance determinations issued during the year. Each Disclosure Statement item number and each Standard for each issue cited in the noncompliance determination will be identified and counted. The following two examples illustrate how the noncompliance determination should be counted.

EXAMPLE 1. An ACO receives an audit report on a proposal indicating a noncompliance with Standard 402 and Item 3.2.3. of the contractor's Disclosure Statement. The ACO makes a determination of noncompliance. The ACO should record a noncompliance with Item 3.2.3. of disclosed practices under the preaward column. He should also include the noncompliance in the totals under "Less: Number Also Involving Standards." In addition, he should record a noncompliance with Standard 402 in the preaward column.

EXAMPLE 2. An ACO receives an audit report on a contract containing the Cost Accounting Standards clause indicating two instances of noncompliance with Standard 401 in the accounting practices of the contractor with regard to travel expenses and freight expenses. The ACO makes a determination of noncompliance on both issues. The ACO should record the noncompliances by indicating two in the count of the noncompliances with Standard 401.

(4) *Disposition of Noncompliance Determinations During the Year.*

	Preaward	Performance
Total Noncompliance Determinations Issued During the Year	_____	_____
Plus: Total Noncompliance Determinations Open - Beginning of Year	_____	_____
Minus: Total Noncompliance Determinations Closed During the Year:		
Through Resolution	_____	_____
Through Nonacceptance of Proposal	_____	_____
Equals: Total Noncompliance Determinations Open - End of Year	_____	_____

This part of the report will account for the disposition of noncompliance determinations. Noncompliance determinations which did not result in the award of a Cost Accounting Standards covered contract will be reported as closed during the year through nonacceptance of the proposal. Noncompliance determinations involving more than one Disclosure Statement item or Standard will be reported as closed only when all such issues have been resolved.

(5) *Increased Costs Recovered Through Noncompliance Determinations Closed During the Year.*

Type	Number	Increased Costs Recovered
Preaward		
Performance		
Total		

This part of the report is to show the increased costs recovered through the resolution of noncompliance determinations for the year. The total number shown above should agree with the Total Noncompliance Determinations Closed During the Year through Resolution as reported in (4) above. For proposal noncompliance, increased costs recovered is taken to mean the difference between an original proposal and a revised one submitted to correct the noncompliance. It shall also include any amounts recovered as indicated by the Pricing Negotiation Memorandum (PNM) required to be furnished by the PCO pursuant to 3–811.

(6) *Substance of Determinations of Noncompliance With CASB Standards.*

This part of the report will consist of a summary of the noncompliances with CASB Standards cited in the ACO's determinations. Determinations which cite substantially the same manner of noncompliance will be reported only once. Each entry should state the substance of the noncomplaince being reported and should be grouped with other noncompliances relating to the same Standard, *e.g.*,

4 CFR 401
(State substance of first noncompliance)
(Continue for each additional noncompliance)

Only those noncompliances cited by ACOs in determinations which have been furnished to contractors in writing shall be included in the report. Contract administration activities will furnish the data required for (2) through (6) of this report.

(7) *Equitable Adjustments.*

This part of the report is to show for each Federal agency the number and value of equitable adjustments completed during the reporting period covering new Standards which resulted in cost increases and the number and value of equitable adjustments which resulted in cost decreases. A separate report will be prepared for each Standard. In addition, when the equitable adjustments involve more than one Standard, an additional consolidated report will be prepared citing the Standards involved. The final result of each negotiated agreement will be shown as a net increase or decrease for each agency affected.

Standard (Cite Standard or Standards Involved)

	Cost Increase		Cost Decrease	
Federal Agency	Number of Negotiated Agreements	Total Dollars	Number of Negotiated Agreements	Total Dollars
DOD				
NASA				
GSA				
(Etc.)				

The following two examples indicate how the reports received from the individual ACO's will be consolidated:

EXAMPLE 1. One ACO reports a negotiated agreement with a contractor to recognize Standard 4 CFR 403. Numerous contracts of DoD and NASA are involved. Some NASA contracts are increased, others are decreased for a net decrease to NASA of $100,000. In the case of DoD there is a net increase of $85,000. A second ACO reports a negotiated agreement involving 4 CFR 403 in which there is a net increase to NASA of $90,000 and a net decrease to DoD of $90,000. In a third negotiated agreement an ACO reports a decrease to NASA of $10,000 and an increase to DoD of $10,000. No other negotiated agreements involving only 4 CFR 403 are reported.

Using the above format, Standard 4 CFR 403 would be cited. For DoD, under the Heading "Cost Increase," the figure "2" would be inserted together with the dollar figure of "$95,000" ($85,000 plus $10,000). Under the "Cost Decrease" the figure "1" would be inserted as well as the dollar figure of "$90,000." For NASA the figure "1" would be shown under "Cost Increase" together with "$90,000." Under "Cost Decrease" the figure "2" would be shown along with "$110,000."

EXAMPLE 2. One ACO reports a negotiated agreement involving Standards 4 CFR 403 and 4 CFR 404. There is a net increase to DoD of $25,000, a decrease to NASA of $15,000, and a decrease to AEC of $5,000. A second ACO reports a negotiated agreement involving 4 CFR 404 and 4 CFR 405. There is a net decrease to DoD of $20,000 and a decrease to NASA of $10,000. A third ACO reports a negotiated agreement involving 4 CFR 403 and 4 CFR 405. There is a net decrease to DoD of $10,000 and an increase to AEC of $15,000.

Using the above format, Standards 4 CFR 403, 404, and 405 would be cited. For DoD the figures under "Cost Increase" would be "1" and "$25,000" respectively. The figures under "Cost Decrease" would be "2" and "$30,000." For NASA the figure "O" would be inserted for both the numbers and dollars under "Cost Increase." The "Cost Decrease" figures would be "2" and "$25,000." For AEC under "Cost Increase" the figures would be "1" and "$15,000." The figures under "Cost Decrease" would be "1" and "$5,000."

(8) *Comments on CASB Promulgations.*

a. Comment on the effect of the Disclosure Statement requirement and Standards issued with respect to:

1. Contractors' proposals.
2. Cost estimation.
3. Contract negotiation.
4. Contract administration.
5. Audits of contract proposals.
6. Audits of incurred costs.

Comments shall deal with the effect of CASB publications both individually and in total. For example, there may be improvements noted in contractors' proposals or there may be information now required that is not useful or necessary. Com-

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ments of any other type may be furnished. Contract administration and purchasing activities shall provide comments for items *1* through *4*. DCAA shall provide comments for items *5* and *6*.

b. Suggestions and recommendations for revising CASB Standards, Rules, or Regulations to:

1. Improve their effectiveness.

2. Facilitate the conduct of negotiations.

3. Facilitate the effectiveness of the procurement function.

4. Facilitate the effectiveness of the audit function.

All information required to be furnished under this paragraph (5) involves personal opinion and judgment. However, to the extent possible each comment or recommendation should be substantiated through use of examples and actual data to support the logic of the suggestions and recommendations. Contract administration and purchasing activities shall provide comments for items *1* through *4*.

(9) *Docket Numbers of Dispute Cases Involving Cost Accounting Standards Board Promulgations.*

ABSCA Docket Numbers of All Open Cases	New Cases	Old Cases	Taken to Court of Claims

In the first column list the docket number of all appeals cases that are before the Armed Services Board of Contract Appeals (ASBCA). For those cases that were assigned docket numbers in the period covered by the report, place an "x" in the column under New Cases. Other cases carried over from previous periods will be marked with an "x" under Old Cases. When a contractor has taken an appeal to the Court of Claims, an "x" will be placed in that column.

3–1211 Waiver of Cost Accounting Standards, Rules and Regulations. In some instances contractors or subcontractors may refuse to accept all or part of the provisions of the Cost Accounting Standards clause in 7–104.83(a). If the PCO determines that it is impractical to obtain the materials, supplies or services from any other source, he shall prepare the documentation required by Paragraph 331.30(c) of Appendix O together with information indicating the date by which a reply is needed to meet the contract placement date. Data required by 331.30(c)(1)(iii) and 331.30(c)(2)(i) of Appendix O is available from the DD 350 Data Bank and may be obtained by contacting the Procurement and Economic Information Division, OASD(C), Washington, D. C. 20301, or calling 202–697–5619. This documentation and information shall be forwarded through channels to the Office of the Assistant Secretary of Defense (I&L) PP, Washington, D. C. 20301. When a waiver is being requested for substantially the same product or service from the same contractor for which a waiver has previously been granted by the Cost Accounting Standards Board, such request for waiver and its documentation may be submitted directly to the Chairman, Cost Accounting Standards Board, by the Assistant Secretary (I&L) for a Military Department or the Director of the Defense Supply Agency.

PROCUREMENT BY NEGOTIATION

3-1212 Administration of Noncompliance Issues.

(a) *Initial Finding of Compliance or Noncompliance.* The ACO shall, upon receipt of a noncompliance report from the auditor, make an initial finding of compliance or noncompliance within 15 days and advise the auditor.

(b) *Notification to Contractor.* If an initial finding of noncompliance is made, the ACO shall immediately notify the contractor in writing of the exact nature of the noncompliance and request him, within 30 days, to agree or submit reasons why he considers his existing practices are in compliance.

(c) *Agreement of Contractor.* If the contractor agrees, he shall:

(i) correct the noncompliance; and

(ii) submit the information required by paragraph (a) of the Administration of Cost Accounting Standards clause (7-104.83(b)).

(d) *Review of Contractor Change.* Upon receipt of the information required in (c) above indicating agreement with the noncompliance, the ACO shall review the accounting change for adequacy and compliance concurrently in accordance with 3-1205(d). Upon completion of the review indicating that the change is both adequate and in compliance, the contractor shall be notified and requested to submit the cost impact proposal required pursuant to paragraph (b) of the Administration of Cost Accounting Standards clause (7-104.83(b)). It shall be in sufficient detail to permit evaluation and negotiation of the cost impact upon each contract and subcontract containing the Cost Accounting Standards clause. It shall contain as a minimum the following information:

(i) identification of all contracts and subcontracts containing the Cost Accounting Standards clause; and

(ii) the effect on each contract and subcontract from the date of failure to comply until the noncompliance is corrected.

(e) *Receipt of Cost Impact Proposal.* Upon receipt of an acceptable proposal from the contractor, the ACO shall promptly analyze the proposal with the assistance of the auditor and negotiate the contract price adjustments pursuant to 3-1207.

(f) *Failure to Submit Cost Impact Proposal.* If the contractor fails to furnish the cost impact proposal in the form and time specified, the ACO shall take action in accordance with paragraph (h) below.

(g) *Disagreement of Contractor.* The ACO shall review the contractor's submission in (b) above and make a determination of compliance or noncompliance.

(h) *Decision of Contracting Officer.*

(1) If the ACO makes a determination of compliance, he shall notify the contractor with a copy to the auditor.

(2) If the ACO makes a determination of noncompliance, or if the contractor fails to furnish the cost impact proposal, the ACO, with the assistance of the auditor shall estimate the cost impact of the noncompliance on contracts and subcontracts containing the Cost Accounting Standards clause.

(3) If the ACO's estimate indicates increased costs to the Government, he shall notify the contractor and request agreement as to the cost or price adjustment, together with any applicable interest. The contractor shall also be advised that in the event no agreement on the cost or price adjustment is reached within 20 days, action may be taken in accordance with paragraph (b) of the Cost Accounting Standards clause (7-104.83(a)). If the ACO subsequently takes such ac-

tion, he shall also consider appropriate action to protect the interests of the Government, pursuant to Appendix E, Part 6, with respect to the amount thus demanded from the contractor.

(4) If the ACO's estimate indicates there are no increased costs as a result of the noncompliance, and the contractor refuses to take corrective action, the ACO shall notify the contractor in writing that he is in noncompliance, that corrective action should be taken, and that if such noncompliance subsequently results in increased costs to the Government, the provisions of the Cost Accounting Standards clause shall be enforced.

3–1213 Administration of Equitable Adjustments for New Standards.

(a) *Additional Solicitation Notice*. Those solicitations required by 3–1203(a) to include the solicitation notice in 7–2003.67(a) shall also include the notice entitled *Additional Cost Accounting Standards Applicable to Existing Contracts* in 7–2003.67(c). The PCO shall assure that the contractor's response to the notice is made known to the ACO. This may be accomplished by attaching a copy of the response to the copy of the contract provided the ACO.

(b) *Requirement for Equitable Adjustment*. Contracts and subcontracts containing the Cost Accounting Standards clause (7–104.83(a)) may require equitable adjustment to comply with new cost accounting standards. Such adjustments are limited to contracts and subcontracts awarded prior to the effective date of each new standard. A new standard becomes applicable prospectively to these contracts and subcontracts when a new contract or subcontract containing the clause is awarded on or after the effective date of such new standard. Contractors are encouraged to submit to the ACO any change in accounting practice in anticipation of complying with a new standard as soon as practicable after the new standard has been finally promulgated by the Cost Accounting Standards Board. Equitable adjustment is limited to those circumstances when a change in cost accounting practices is required to implement a new standard.

(c) *Review of Contractor Change*. Upon receipt of information required pursuant to paragraph (a) of the Administration of Cost Accounting Standards clause (7–104.83(b)) from the contractor indicating an accounting change is required to comply with a new standard, the ACO shall review the proposed change concurrently for adequacy and compliance in accordance with 3–1205(d). Upon completion of the review indicating that the change is both adequate and in compliance, the contractor shall be notified and requested to submit the cost impact proposal required pursuant to paragraph (b) of the Administration of Cost Accounting Standards clause (7–104.83(b)). It shall be in sufficient detail to permit evaluation and negotiation of the cost impact upon each contract and subcontract containing the Cost Accounting Standards clause. It shall contain as a minimum the following information:

(i) identification of each additional standard, together with contract and subcontracts containing the Cost Accounting Standards clause having an award date prior to the effective date of such standard; and

(ii) the effect on each contract and subcontact from the date the contractor is required to follow the standard until completion of the contract or subcontract.

(d) *Receipt of Cost Impact Proposal.* Upon receipt of an acceptable proposal from the contractor, the ACO shall promptly analyze the proposal with the assistance of the auditor and negotiate the contract price adjustments pursuant to 3-1207.

(e) *Failure to Submit Cost Impact Proposal or Reach Agreement Concerning Cost Impact.*

(1) If the contractor does not submit a proposal in the form and time specified or if the parties fail to agree concerning the cost impact, the ACO, with the assistance of the auditor, shall estimate the cost impact on contracts and subcontracts containing the Cost Accounting Standards clause.

(2) Upon completion of the estimate indicating the effect on contract costs, the ACO shall request agreement from the contractor as to the cost or price adjustment. The contractor shall also be advised that in the event no agreement on the cost or price adjustment is reached within 20 days, action may be taken in accordance with the Disputes clause of the contract. If the ACO issues a unilateral determination under the Disputes clause, he shall consider appropriate action to protect the interests of the Government, with respect to the amount demanded from the contractor, pursuant to Appendix E, Part 6.

3-1214 Administration of Voluntary Changes.

(a) *Notification of Proposed Change.* When a contractor who has contracts or subcontracts containing the Cost Accounting Standards clause (7-104.83(a)) plans to make a voluntary change to an accounting practice, he must submit the information required by paragraph (a) of the Administration of Cost Accounting Standards clause (7-104.83(b)).

(b) *Review of Contractor Change.* Upon receipt of the information required in (a) above, the ACO shall review the accounting change concurrently for adequacy and compliance in accordance with 3-1205(d). Upon completion of the review indicating that the change is both adequate and in compliance, the contractor shall be notified and requested to furnish the cost impact proposal required pursuant to paragraph (b) of the Administration of Cost Accounting Standards clause (7-104.83(b)). It shall be in sufficient detail to permit evaluation and negotiation of the cost impact upon each contract and subcontract containing the Cost Accounting Standards clause. It shall contain as a minimum the following information:

(i) identification of all contracts and subcontracts containing the Cost Accounting Standards clause; and

(ii) the effect on each contract and subcontract from the effective date of the proposed change until completion of the contract or subcontract.

(c) *Receipt of Cost Impact Proposal.* Upon receipt of an acceptable proposal from the contractor, the ACO shall promptly analyze the proposal with the assistance of the auditor for purposes of determining whether or not the proposed change will result in increased costs being paid by the United States. In considering the proposed adjustments to subcontracts containing the Cost Accounting Standards clause for the purposes of determining whether increased cost to the United States will result from the change, the ACO shall not consider the effect of the proposed adjustments upon the prime contracts and subcontracts under which

the subcontracts were entered into. If the ACO determines that the proposed adjustments will not result in an increase in the aggregate cost to be paid under the contracts and subcontracts, containing the Cost Accounting Standards clause, he shall promptly negotiate the contract price adjustments pursuant to 3–1207. If the ACO determines that the proposed adjustments will result in an increase in the aggregate cost to be paid under the contracts and subcontracts containing the Cost Accounting Standards clause, he shall so notify the contractor and advise him that the proposed change will not be recognized unless an agreement can be reached which will prevent an increase in the aggregate cost to be paid under such contracts and subcontracts.

(d) *Failure to Submit Cost Impact Proposal or Reach Agreement Concerning Cost Impact.*

(1) If the contractor does not submit a proposal in the form and time specified or if the parties fail to agree concerning the cost impact, the ACO, with the assistance of the auditor, shall estimate the cost impact on contracts and subcontracts containing the Cost Accounting Standards clause.

(2) Upon completion of the estimate indicating the effect on contract costs, the ACO shall request agreement from the contractor as to the cost or price adjustment. The contractor shall also be advised that in the event no agreement on the cost or price adjustment is reached within 20 days, action may be taken in accordance with the Disputes clause of the contract. If the ACO issues a unilateral determination under the Disputes clause, he shall consider appropriate action to protect the interests of the Government, with respect to the amount demanded from the contractor, pursuant to Appendix E, Part 6.

on the amount of the claim finally determined owed by the Government shall be payable to the Contractor. Such interest shall be at the rate established by the Secretary of the Treasury pursuant to Public Law 92-41; 85 STAT 97 for the Renegotiation Board from the date the Contractor furnishes to the Contracting Officer his written appeal pursuant to the DISPUTES clause of this contract, to the date of (i) a final judgment by a court of competent jurisdiction, or (ii) mailing to the Contractor of a supplemental agreement for execution either confirming completed negotiations between the parties or carrying out a decision of a Board of Contract Appeals.

(b) Notwithstanding (a) above, (i) interest shall be applied only from the date payment was due, if such date is later than the filing of appeal; and (ii) interest shall not be paid for any period of time that the Contracting Officer determines the Contractor has unduly delayed in pursuing his remedies before a Board of Contract Appeals or a court of competent jurisdiction.

(End of clause)

7-104.83 *Cost Accounting Standards.*

(a) In accordance with 3-1204, insert the following clause:

COST ACCOUNTING STANDARDS (1975 FEB)

(a) Unless the Cost Accounting Standards Board has prescribed rules or regulations exempting the Contractor or this contract from standards, rules, and regulations promulgated pursuant to 50 U.S.C. App. 2168 (Public Law 91-379, August 15, 1970), the Contractor, in connection with this contract shall:

(1) By submission of a Disclosure Statement, disclose in writing his cost accounting practices as required by regulations of the Cost Accounting Standards Board. The required disclosures must be made prior to contract award unless the Contracting Officer provides a written notice to the Contractor authorizing post-award submission in accordance with regulations of the Cost Accounting Standards Board. The practices disclosed for this contract shall be the same as the practices currently disclosed and applied on all other contracts and subcontracts being performed by the Contractor and which contain this Cost Accounting Standards clause. If the Contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets and commercial or financial information which is privileged and confidential, the Disclosure Statement will be protected and will not be released outside the Government.

(2) Follow consistently the cost accounting practices disclosed pursuant to (1) above in accumulating and reporting contract performance cost data concerning this contract. If any change in disclosed practices is made for purposes of any contract or subcontract subject to Cost Accounting Standards Board requirements, the change must be applied prospectively to this contract, and the Disclosure Statement must be amended accordingly. If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) below, as appropriate.

(3) Comply with all Cost Accounting Standards in effect on the date of award of this contract or if the Contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the Contractor's signed certificate of current cost or pricing data. The Contractor shall also comply with any Cost Accounting Standard which hereafter becomes applicable to a contract or subcontract of the Contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract.

(4)(A) Agree to an equitable adjustment as provided in the changes clause of this contract if the contract cost is affected by a change which, pursuant to (3) above, the contractor is required to make to his established cost accounting practices whether such practices are covered by a Disclosure Statement or not.

(B) Negotiate with the Contracting Officer to determine the terms and conditions under which a change to either a disclosed cost accounting practice or an established cost accounting practice, other than a change under (4)(A) above, may be made. A change to a practice may be proposed by either the Government or the Contractor, *provided*, however, that no agreement may be made under this provision that will increase costs paid by the United States.

(5) Agree to an adjustment of the contract price or cost allowance, as appropriate, if he or a subcontractor fails to comply with an applicable Cost Accounting Standard or to follow any prac-

tice disclosed pursuant to subparagraphs (a)(1) and (a)(2) above and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States together with interest thereon computed at the rate determined by the Secretary of the Treasury pursuant to Public Law 92–41, 85 STAT. 97, or seven percent (7%) per annum, whichever is less, from the time the payment by the United States was made to the time the adjustment is effected.

(b) If the parties fail to agree whether the Contractor or a subcontractor has complied with an applicable Cost Accounting Standard, rule, or regulation of the Cost Accounting Standards Board and as to any cost adjustment demanded by the United States, such failure to agree shall be a dispute concerning a question of fact within the meaning of the disputes clause of this contract.

(c) The Contractor shall permit any authorized representatives of the head of the agency, of the Cost Accounting Standards Board, or of the Comptroller General of the United States to examine and make copies of any documents, papers, or records relating to compliance with the requirements of this clause.

(d) The Contractor shall include in all negotiated subcontracts which he enters into the substance of this clause except paragraph (b), and shall require such inclusion in all other subcontracts of any tier, except that this requirement shall apply only to negotiated subcontracts in excess of $100,000 where the price negotiated is not based on:

(i) established catalog or market prices of commercial items sold in substantial quantities to the general public, or

(ii) prices set by law or regulation and except that the requirement shall not apply to negotiated subcontracts otherwise exempt from the requirement to accept the Cost Accounting Standards clause by reason of Section 331.30(b) of Title 4 Code of Federal Regulations (4 CFR 331.30(b)).

NOTE: (1) Subcontractors shall be required to submit their Disclosure Statements to the Contractor. However, if a subcontractor has previously submitted his Disclosure Statement to a Government Administrative Contracting Officer (ACO) he may satisfy that requirement by certifying to the Contractor the date of such Statement and the address of the ACO.

(2) In any case where a subcontractor determines that the Disclosure Statement information is privileged and confidential and declines to provide it to his Contractor or higher tier subcontractor, the Contractor may authorize direct submission of that subcontractor's Disclosure Statement to the same Government offices to which the Contractor was required to make submission of his Disclosure Statement. Such authorization shall in no way relieve the Contractor of liability as provided in paragraph (a)(5) of this clause. In view of the foregoing and since the contract may be subject to adjustment under this clause by reason of any failure to comply with rules, regulations, and Standards of the Cost Accounting Standards Board in connection with covered subcontracts, it is expected that the Contractor may wish to include a clause in each such subcontract requiring the subcontractor to appropriately indemnify the Contractor. However, the inclusion of such a clause and the terms thereof are matters for negotiation and agreement between the Contractor and the subcontractor, provided that they do not conflict with the duties of the Contractor under its contract with the Government. It is also expected that any subcontractor subject to such indemnification will generally require substantially similar indemnification to be submitted by his subcontractors.

(e) The terms defined in Section 331.20 of Part 331 of Title 4, Code of Federal Regulations (4 CFR 331.20) shall have the same meanings herein. As there defined, "negotiated subcontract" means "any subcontract except a firm fixed-price subcontract made by a Contractor or subcontractor after receiving offers from at least two firms not associated with each other or such Contractor or subcontractor, providing (1) the solicitation to all competing firms is identical, (2) price is the only consideration in selecting the subcontractor from among the competing firms solicited, and (3) the lowest offer received in compliance with the solicitation from among those solicited is accepted."

(End of clause)

(b) *Administration of Cost Accounting Standards.* In accordance with 3–1204, insert the following clause.

CONTRACT CLAUSES AND SOLICITATION PROVISIONS

ADMINISTRATION OF COST ACCOUNTING STANDARDS (1975 MAR)

For the purpose of administering Cost Accounting Standards requirements under this contract, the Contractor shall:

(a) Submit to the cognizant Contracting Officer a description of the accounting change and the general dollar magnitude of the change to reflect the sum of all increases and the sum of all decreases for all contracts containing the Cost Accounting Standards clause (7-104.83(a)):

(i) for any change in cost accounting practices required to comply with a new Cost Accounting Standard in accordance with paragraphs (a)(3) and (a)(4)(A) of the clause of this contract entitled "*Cost Accounting Standards*" within sixty (60) days (or such other date as may be mutually agreed to) after award of a contract requiring such change;

(ii) for any change to cost accounting practices proposed in accordance with paragraph (a)(4)(B) of the clause of this contract entitled "*Cost Accounting Standards*" not less than sixty (60) days (or such other date as may be mutually agreed to) prior to the effective date of the proposed change; or

(iii) for any failure to comply with an applicable Cost Accounting Standard or to follow a disclosed practice as contemplated by paragraph (a)(5) of the clause of this contract entitled "*Cost Accounting Standards*" within sixty (60) days (or such other date as may be mutually agreed to) after the date of agreement of such noncompliance by the Contractor.

(b) Submit a cost impact proposal in the form and manner specified by the cognizant Contracting Officer within sixty (60) days (or such other date as may be mutually agreed to) after the date of determination of the adequacy and compliance of a change submitted pursuant to (a)(i), (ii), or (iii) above.

(c) Agree to appropriate contract and subcontract amendments to reflect adjustments established in accordance with paragraphs (a)(4) and (a)(5) of the clause of this contract entitled "*Cost Accounting Standards.*"

(d) Include the substance of this clause in all negotiated subcontracts containing the clause entitled "*Cost Accounting Standards.*" In addition, include a provision in these subcontracts which will require such subcontractors, within thirty (30) days after receipt of award, to submit the following information to the Contract Administration Office cognizant of the subcontractor's facility.

(1) Subcontractor's name and subcontract number.

(2) Dollar amount and date of award.

(3) Name of Contractor making the award.

(4) A statement as to whether the subcontractor has made or proposes to make any changes to accounting practices that affect prime contracts or subcontracts containing the *Cost Accounting Standards* clause unless such changes have already been reported. If award of the subcontract results in making a Cost Accounting Standard(s) effective for the first time, this shall also be reported.

(e) In the event an adjustment is required to be made to any subcontract hereunder, notify the Contracting Officer in writing of such adjustment and agree to an adjustment in the price or estimated cost and fee of this contract, as appropriate, based upon the adjustment established under the subcontract. Such notice shall be given within thirty (30) days after receipt of the proposed subcontract adjustment, and shall include a proposal for adjustment to such higher tier subcontract or prime contract as appropriate.

(f) When the *Cost Accounting Standards* clause and this clause are included in subcontracts, the term "Contracting Officer" shall be suitably altered to identify the purchaser.

(End of clause)

7-104.84 *Fast Payment Procedure.*

(a) In accordance with 3-606.3, the following clause shall be used in small purchases:

(The next page is 7:129)

SHIPPING POINT(S) USED IN EVALUATION OF F.O.B. ORIGIN BIDS (OR PROPOSALS) (1968 JUN)

A. If more than one shipping point or plant is designated by the bidder (or offeror) and he fails to indicate the quantity per shipping point or plant prior to bid opening (or the closing date specified for receipt of proposals), the Government will evaluate the bid (or proposal) on the basis of delivery of the entire quantity from the point or plant where cost of transportation is most favorable to the Government.

B. If the bidder (or offeror), prior to bid opening (or the closing date specified for receipt of proposals), fails to indicate any shipping point or plant, the Government will evaluate the bid (or proposal) on the basis of delivery from the plant at which the contract will be performed, as indicated in the bid or proposal. If no such plant is indicated in the bid (or proposal), then the bid (or proposal) will be evaluated on the basis of delivery from the Contractor's business address indicated on Standard Form 33 or other bid (proposal) form.

C. If the bidder (or offeror) utilizes a shipping point other than that which has been used by the Government as a basis for the evaluation of bids (or proposals), any increase of transportation costs shall be borne by the Contractor and any savings shall revert to the Government.

(End of provision)

(d) *FOB Origin and/or Destination.* In accordance with 2–201(a)Sec.D(x), insert the following provision.

F.O.B. ORIGIN AND/OR DESTINATION (1968 JUN)

Bids (Offers) are invited on the basis of both, f.o.b. origin and f.o.b. destination, and the Government will award on such basis as the Contracting Officer determines to be most advantageous to the Government. A bid (An offer) on the basis of f.o.b. origin only or f.o.b. destination only is acceptable, but will be evaluated only on the basis submitted.

(End of provision)

7–2003.25 *Bid Guarantee.* The following provision shall be included in solicitations in accordance with 10–102.4.

BID GUARANTEE (1964 JUN)

Where a bid guarantee is required by the invitation for bids, failure to furnish a bid guarantee in the proper form and amount, by the time set for opening of bids, may be cause for rejection of the bid.

A bid guarantee shall be in the form of a firm commitment, such as a bid bond, postal money order, certified check, cashier's check, irrevocable letter of credit or, in accordance with Treasury Department regulations, certain bonds or notes of the United States. Bid guarantees, other than bid bonds, will be returned (a) to unsuccessful bidders as soon as practicable after the opening of bids, and (b) to the successful bidder upon execution of such further contractual documents and bonds as may be required by the bid as accepted.

If the successful bidder, upon acceptance of his bid by the Government within the period specified therein for acceptance (sixty days if no period is specified) fails to execute such further contractual documents, if any, and give such bond(s) as may be required by the terms of the bid as accepted within the time specified (ten days if no period is specified) after receipt of the forms by him, his contract may be terminated for default. In such event he shall be liable for any cost of procuring the work which exceeds the amount of his bid, and the bid guarantee shall be available toward offsetting such difference.

(End of provision)

CONTRACT CLAUSES AND SOLICITATION PROVISIONS

7-2003.26 *Reserved.*

7-2003.27 *Cost Limitation.* In accordance with 2-201(b)(xxx) or 3-501(c)(xxv), insert the following provision.

COST LIMITATION (1974 APR)

A bid which does not contain separate bid prices for the items identified as subject to a cost limitation may be considered nonresponsive. A bidder by signing his bid certifies that each price bid on items subject to a cost limitation includes an appropriate apportionment of all applicable estimated costs, direct and indirect, as well as overhead and profit. Bids may be rejected which (i) have been materially unbalanced for the purpose of bringing affected items within cost limitations, or (ii) exceed the cost limitations unless such limitations have been waived by the Assistant Secretary of Defense (Installations and Logistics) prior to award.

(End of provision)

7-2003.28 *Additive or Deductive Items.* In accordance with 2-201(b)(xli), insert a provision substantially as follows.

ADDITIVE OR DEDUCTIVE ITEMS (1968 APR)

The low bidder for purposes of award shall be the conforming responsible bidder offering the low aggregate amount for the first or base bid item, plus or minus (in the order of priority listed in the schedule) those additive or deductive bid items providing the most features of the work within the funds determined by the Government to be available before bids are opened. If addition of another bid item in the listed order of priority would make the award exceed such funds for all bidders, it shall be skipped and the next subsequent additive bid item in a lower amount shall be added if award thereon can be made within such funds. For example, when the amount available is $100,000 and a bidder's base bid and four successive additives are $85,000, $10,000, $8,000, $6,000 and $4,000, the aggregate amount of the bid for purposes of award would be $99,000 for the base bid plus the first and fourth additives, the second and third additives being skipped because each of them would cause the aggregate bid to exceed $100,000. In any case all bids shall be evaluated on the basis of the same additive or deductive bid items, determined as above provided. The listed order of priority need be followed only for determining the low bidder. After determination of the low bidder as stated, award in the best interests of the Government may be made to him on his base bid and any combination of his additive or deductive bid for which funds are determined to be available at the time of the award, provided that award on such combination of bid items does not exceed the amount offered by any other conforming responsible bidder for the same combination of bid items.

(End of provision)

7-2003.29 *Telegraphic Bids.* In accordance with 2-202.2, and 3-501(b)Sec.C(iii), insert the following provision.

CONTRACT CLAUSES AND SOLICITATION PROVISIONS

Date of Disclosure Statement(s): .....
Name(s) and Address(es) of Cognizant
ACO(s) where filed: ....

The offeror further certifies that practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the Disclosure Statement(s).

( ) II. CERTIFICATE OF MONETARY EXEMPTION

The offeror hereby certifies that, together with all divisions, subsidiaries, and affiliates under common control, he did not receive net awards of negotiated national defense prime contracts totaling more than $30,000,000 in Federal Fiscal Year 1971 or net awards of negotiated national defense prime contracts of the type which are subject to Cost Accounting Standards totaling more than $10,000,000 in either Federal Fiscal Year 1972 or 1973.

( ) III. CERTIFICATE OF PREVIOUSLY SUBMITTED DISCLOSURE STATEMENT(S)

The offeror hereby certifies that the Disclosure Statement(s) were filed as follows:

Date of Disclosure Statement(s): .....
Name(s) and Address(es) of Cognizant
ACO(s) where filed: ....

The offeror further certifies that practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the Disclosure Statement(s).

(End of provision)

(b) *Cost Accounting Standards - Exemption for Contracts of $500,000 or Less.* In accordance with 3–1204, insert the following provision.

COST ACCOUNTING STANDARDS - EXEMPTION FOR CONTRACTS OF $500,000 OR LESS (1975 MAR)

If this proposal is expected to result in the award of a contract of $500,000 or less, the offeror shall indicate whether the exemption to the Cost Accounting Standards clause (7–104.83(a)) under the provisions of 4 CFR 331.30(b)(8) is claimed. Failure to check the box below shall mean that the resultant contract is subject to the Cost Accounting Standards clause or that the offeror elects to comply with such clause.

( ) The offeror hereby claims an exemption from the Cost Accounting Standards clause under the provisions of 4 CFR 331.30(b)(8) and certifies that he has received notification of final acceptance of all deliverable items on (i) all prime contracts or subcontracts in excess of $500,000 which contain the Cost Accounting Standards clause, and (ii) all prime contracts or subcontracts of $500,000 or less awarded after January 1, 1975 which contain the Cost Accounting Standards clause. The offeror further certifies he will immediately notify the Contracting Officer in writing in the event he is awarded any other contract or subcontract containing the Cost Accounting Standards clause subsequent to the date of this certificate but prior to the date of any award resulting from this proposal.

(End of provision)

(c) In accordance with 3–1213(a), insert the following provision in all solicitations containing the clause in 7–2003.67(a).

ADDITIONAL COST ACCOUNTING STANDARDS APPLICABLE TO EXISTING CONTRACTS (1975 MAR)

The offeror shall indicate below whether award of the contemplated contract would, in accordance with paragraph (a)(3) of the *Cost Accounting Standards* clause (7–104.83(a)), require a change in his established cost accounting practices affecting existing contracts and subcontracts.

( )YES ( )NO

NOTE: If the offeror has checked "yes" above, and is awarded the contemplated contract, he will be required to comply with the *Administration of Cost Accounting Standards* clause (7-104.83(b)).

(End of provision)

7-2003.68 *Industrial Preparedness Production Planning*. In accordance with 3-501(b)Sec.C(xlvii), insert the following provision.

INDUSTRIAL PREPAREDNESS PRODUCTION PLANNING (1974 APR)

This solicitation includes an item for industrial planning in support of the Industrial Preparedness Production Planning program. Offerors are cautioned to carefully review Section E of the Schedule and the attached Industrial Preparedness Program Planning Exhibit. Failure to propose on the Industrial Preparedness Production Planning line item set forth in the Schedule may result in rejection of the proposal.

(End of provision)

7-2003.69 *Industrial Preparedness Production Planning*. In accordance with 2-201(a)Sec.C(xxxix), insert the following provision.

INDUSTRIAL PREPAREDNESS PRODUCTION PLANNING (1974 APR)

This solicitation includes an item for industrial planning in support of the Industrial Preparedness Production Planning program. Bidders are cautioned to carefully review Section E of the Schedule and the attached Industrial Preparedness Production Planning Exhibit or Attachment. Failure to bid on the Industrial Preparedness Production Planning line item set forth in the Schedule may result in rejection of the bid.

(End of provision)

7-2003.70 *Evaluation of Transportation Costs*. In accordance with 19-208.4(b), insert the following provision.

EVALUATION OF TRANSPORTATION COSTS (1974 APR)

Costs of transporting supplies to be delivered under this contract will not be an evaluation factor for award.

(End of provision)

SECTION XIV

PROCUREMENT QUALITY ASSURANCE

14–000 Scope of Section. This Section prescribes policies and procedures (i) to assure that supplies and services procured by the Department of Defense conform to the quality and quantity set forth in the contract and (ii) for the acceptance functions associated therewith.

14–001 Definitions. As used in this Section, the words and terms described in this paragraph shall have the meanings set forth below.

14–001.1 *Government Procurement Quality Assurance* means the Government function by which the Government determines whether a contractor has fulfilled his contract obligations pertaining to quality and quantity. This function is related to and generally precedes the act of acceptance as defined in 14–001.6 below.

14–001.2 *Contract Quality Requirements* means the detailed requisites for quality incumbent on the contractor, consisting of (i) all quality requirements contained in a contract; and (ii) the detailed contractual requisites provided by 14–101 incumbent on the contractor to substantiate conformance of product or service to quality requirements of the contract.

14–001.3 *Inspection* means the examination and testing of supplies or services (including, when appropriate, raw materials, components, and intermediate assemblies) to determine whether they conform to contract requirements.

14–001.4 *Testing* is an element of inspection and generally denotes the determination by technical means of the properties or elements of supplies, or components thereof, including functional operation, and involves the application of established scientific principles and procedures.

14–001.5 *Subcontractor* means any supplier, distributor, vendor, or firm which furnished supplies or services to or for a prime contractor or another subcontractor.

14–001.6 *Acceptance* means the act of an authorized representative of the Government by which the Government assumes for itself, or as agent of another, ownership of existing and identified supplies tendered or approves specific services rendered, as partial or complete performance of the contract on the part of the contractor.

14–001.7 *Off-The-Shelf Item* means an item produced and placed in stock by a contractor prior to the contractor receiving orders or contracts for the sale of the item. The contractor may produce the items to either commercial or military/federal item specifications or descriptions. Off-the-shelf items include items stocked by distributors for which Government contracts may be received.

PROCUREMENT QUALITY ASSURANCE

Part 1—General

14–101 Types of Contract Quality Requirements. There are five basic categories of contract coverage for assuring conformance of products or services to contract requirements: (a) not including any specific quality requirement in the contract, in which case the Government does not perform any procurement quality assurance actions at source, but instead relies on the contractor's internal control to obtain the supplies or services specified in the contract; (b) contractor responsibility provisions (14–101.1); (c) standard inspection requirement (14–101.2); (d) MIL-I–45208 Inspection System Requirement (14–101.3); and, (e) MIL-Q–9858 Quality Program Requirement (14–101.4). MIL-I–45208, Inspection System Requirement ., or MIL-Q–9858, Quality Program Requirement ., shall not be specified for off-the-shelf items.

14–101.1 *Contractor Responsibility Provisions*, making the contractor responsible for the inspection and test of products before offering them to the Government, are effected by:

(i) citing in the contract Federal-Military Specifications which contain a "Responsibility for Inspection" clause in Section 4, "Quality Assurance Provisions" of the Specifications;

(ii) citing in the contract Federal-Military drawings which carry a note relative to the contractor's responsibility for inspection and test and

(iii) including the clause in 7–103.24 in the contract.

14–101.2 *Standard Inspection Requirement* is a requirement that the contractor maintain an inspection system acceptable to the Government. This requirement is included in the standard inspection clauses (see, for example, paragraph (e) of the Inspection clause in 7–103.5(a)) and is not further defined by a Government specification. This requirement is appropriate when for reasons of practicability (*e.g.*, purchase of a commercial item) or because of the nature of the supplies (*i.e.*, the item serves a function that is not materially or consequentially related to military operations), it is not considered necessary to describe further what constitutes an acceptable inspection system.

14–101.3 *Inspection System Requirement* is a requirement, in addition to the Standard Inspection Requirement, that the contractor establish and maintain an inspection system in accordance with a Government specification. This requirement shall be referenced in contracts when technical requirements are such as to require control of quality by in-process as well as final end item inspection, including control of such elements of the manufacturing process as measuring and testing equipment, drawings and changes, inspection, documentation and records. The objectives and essential elements of an inspection system are prescribed in MIL-I–45208, which shall be referenced in contracts when an inspection system requirement has been established.

14–101.4 *Quality Program Requirement* is a requirement, in addition to the Standard Inspection Requirement, that the contractor establish and maintain a quality program in accordance with a Government specification. Such a requirement shall be established when the technical requirements of the contract are such as to require control of work operations, in-process controls, and inspection, as well as attention to other factors (*e.g.*, organization, planning, work instruc-

tions, documentation control, advanced metrology). The objectives and essential elements of a quality program are prescribed in MIL-Q-9858 which shall be referenced in contracts when a quality program requirement has been established.

14-101.5 *Criteria for Applying Contract Quality Requirements.*

(a) Suggested aids in proper selection of contract quality requirements:

(i) Classification by type of contract quality requirement:

(A) *No Specific Contract Quality Requirement.* Generally used in purchases under Section III, Part 6, where there is no specific obligation on the contractor for the performance of inspection and no Government procurement quality assurance actions can be performed at source.

(B) *Contractor Responsibility Clause.* (See 14-101.1.) Use of this requirement alone is restricted to purchases under Section III, Part 6.

(C) *Standard Inspection Requirement.* (See 14-101.2.) Must be used on all fixed price supply contracts over $10,000. It may be used alone or in conjunction with Contractor Responsibility clause on purchases under Section III, Part 6. It must be used with the MIL-I-45208 and MIL-Q-9858.

(D) *MIL-I-45208 and MIL-Q-9858.* (See 14-101.3 and 14-101.4.) Technical personnel shall be consulted before including one of these specifications in a contract.

(ii) Classification by contract item technical description:

(A) *Commercial* (catalogs, drawings, industrial standards).

(B) *Military-Federal* (drawings, specifications).

(C) *Off-the-shelf* (See 14-001.7)

(iii) Classification by type of items:

(A) *Complex items* have quality characteristics, not wholly visible in the end item, for which contractual conformance must progressively be established through precise measurements, tests and controls accomplished during purchasing, manufacturing, assembly, and functional operations either as an individual item or in conjunction with other items.

(B) *Noncomplex items* have quality characteristics for which simple measurement and test of the end item is sufficient to determine conformance to contract requirements.

(iv) Classification by type of application:

(A) *Critical.* A critical application of an item is one in which the failure of the item could injure personnel or jeopardize a military mission. Critical items may be either:

(i) peculiar, meaning items which have only one application, or

(ii) common, meaning items which have multiple applications.

Whether peculiar or common, purchases of critical items must have contract quality requirements.

(B) *Noncritical.* A noncritical application is any application which is not critical. Noncritical items may also be either peculiar or common.

PROCUREMENT QUALITY ASSURANCE

(b) *Application of the Criteria.* Decisions must be made as to whether the item is off-the-shelf, or commercial or Military-Federal, complex or noncomplex and whether its application is critical or noncritical, peculiar or common. Once these decisions are made, the table below will indicate the proper contract quality requirement.

Item Technical Description	*Kind of Item*	*Application*	*Type of Contract Quality Requirement*
Commercial	Noncomplex	Noncritical Common	14–101(a)
Commercial	Noncomplex	Noncritical Peculiar	14–101(a)
Commercial	Noncomplex	Critical	14–101(c)
Commercial	Complex	Noncritical Common	14–101(a)
Commercial	Complex	Noncritical Peculiar	14–101(c)
Commercial	Complex	Critical	14–101(d)
Military-Federal	Noncomplex	Noncritical Common	14–101(c)
Military-Federal	Noncomplex	Noncritical Peculiar	14–101(c)
Military-Federal	Noncomplex	Critical	14–101(d)
Military-Federal	Complex	Noncritical Common	14–101(c)
Military-Federal	Complex	Noncritical Peculiar	14–101(d)
Military-Federal	Complex	Critical	14–101(e)
Off-the-Shelf	All	Noncritical	14–101(a)
Off-the-Shelf	All	Critical	14–101(c)

(c) The table in (b) above is intended for use as a guide in selecting the contract quality requirement normally considered appropriate for the given item criteria. However, where circumstances warrant, a contract quality requirement of a greater or lesser degree than that arrived at through use of this table may be specified by the PCO except for off-the-shelf items as defined in 14–001.7.

14–102 Responsibilities of the Contractor.

(a) The contractor is responsible for carrying out his obligations as set forth in the terms and conditions of the contract and in the applicable specifications. Most Department of Defense contracts include, or reference, standard requirements, such as those in general provisions, special clauses for an inspection system or quality program, and performance and product specification require-

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ments. The contractor is responsible for controlling product quality and for offering to the Government for acceptance only those supplies and services that conform to contract requirements and, when required, for maintaining and furnishing substantiating evidence of this conformance.

(b) The control of quality by the contractor may relate to, but is not limited to:

(i) manufacturing processes, to assure that the product is produced in accordance with technical requirements;

(ii) drawings, specifications, and engineering changes, to assure that manufacturing methods and operations reflect technical requirements;

(iii) testing and examination, to assure that practices and equipment provide the means for optimum evaluation of characteristics subjected to inspection;

(iv) reliability and maintainability assessment (life, endurance, and continued readiness);

(v) fabrication and delivery of products to assure that only conforming products are tendered to the Government;

(vi) technical documentation, including drawings, specifications, handbooks, manuals, and other technical publications; and

(vii) preservation, packaging, packing and marking.

14–103 Responsibilities of the Government. The Government shall determine the type and extent of Government procurement quality assurance actions required, based upon the particular procurement. These actions may include:

(i) inspection of supplies and services;

(ii) review of the contractor's inspection system, quality program, or of any other means employed by the contractor to control quality and to comply with contract requirements;

(iii) maintenance of Government records to reflect actions, deficiencies, and corrective measures; and

(iv) review and evaluation of quality information, including reports from the user, to initiate required corrective actions or to adjust Government procurement quality assurance actions.

14–103.1 *Subcontracts.* Government procurement quality assurance at subcontractor's plants shall be performed only when necessary to assist the contract administration office cognizant at the prime contractor's plant. Paragraph 14–407 provides guidance on Government procurement quality assurance actions at the subcontract level.

14–103.2 *Specialized Inspections Reserved to the Government.* Although contracts generally require that contractors are responsible for performing inspection prior to submitting supplies to the Government, there are situations when contracts will provide for specialized inspections to be performed solely by the Government. Among situations for which specialized Government inspection is required are the following:

(i) test requirements necessitate the use of specialized test equipment or facilities not ordinarily available in suppliers' plants or commercial laboratories (*e.g.*, ballistic testing of ammunition, unusual environmental tests, or simulated service tests); or

(ii) the contract requires Government testing for first article approval (see Section I, Part 19).

PROCUREMENT QUALITY ASSURANCE

Part 2—Responsibilities of Government Organizations

14–201 Organization Responsible for Technical Requirements.

(a) The activity responsible for technical requirements (*e.g.*, specifications, drawings and standards) is responsible for prescribing inspection, testing, or other contract quality requirements that are essential to assure the integrity of products and services.

(b) To the extent feasible, alternative but substantially equivalent inspection methods shall be provided in order to obtain wide competition and low cost. Contractor-recommended alternatives may be authorized when in the interest of the Government and after approval by the activity responsible for technical requirements.

(c) The activity responsible for technical requirements may also prepare instructions regarding the type and extent of Government inspections pertaining to contracts for specific supplies or services that are complex or for which unusual requirements have been established. Such instructions shall be kept to a minimum taking into account the policy contained in 14–403(a). Normally, issuance of these instructions will not be appropriate for standard commercial items except when items having critical characteristics are being purchased. After issuance of these instructions, production problems, product-oriented visits, user experience and input from the contract administration office shall be analyzed periodically to determine whether conditions warrant a change in type and extent of the inspection requirements. Such analysis may result in decreasing or increasing Government inspection. These instructions shall be prepared on a contract-by-contract basis and shall not be issued:

(i) as a substitute for incomplete contract quality requirements;
(ii) where the contract does not impose equal or greater inspection requirements on the contractor;
(iii) encompassing broad or general designations such as "all requirements," "all characteristics," or "all characteristics in the classification of defects;"
(iv) on routine administrative procedures; or
(v) specifying continued inspection requirements when statistically sound sampling will provide an adequate degree of protection.

(d) In the preparation of such instructions, the technical activity shall consider, to the extent available and applicable, such factors as:

(i) the past quality history of the contractor;
(ii) the criticality of the materiel procured in relation to its ultimate use considering such factors as reliability, safety and interchangeability;
(iii) problems encountered in the development of the product;
(iv) problems encountered in the acquisition of the same or similar materiel;
(v) previously generated feedback data from receiving, testing or using activities; and
(vi) other contractor's experience in overcoming manufacturing problems.

When knowledge of the determining factors, which resulted in the requirement for Government inspection, would be useful to the contract administration office in performing the procurement quality assurance function, these factors should be provided to the contract administration office.

14–202 Purchasing Office.

(a) The purchasing office is responsible after coordinating, where necessary, with the technical activity for contractually formalizing requirements for quality and, within the provisions of 14–201(c), issuing Government inspection instructions to the contract administration office. The purchasing office shall include, in each solicitation and resultant contract, by contract clause, exhibit or specification reference, appropriate requirements for the contractor's control of quality for the supplies or services to be procured (see 14–302 through 14–304).

(b) The purchasing office may conduct, in conjunction where necessary, with the activity responsible for technical requirements, product-oriented surveys and evaluations to determine the adequacy of the technical requirements relating to quality and product conformance to design intent. The purchasing office may arrange with the contract administration office to participate in pre-award surveys, post-award, and pre-production conferences, and first article testing. The purchasing office may aid the contract administration office in the transition from research and development to production, aid the technical activity in improving the quality requirements in contracts when first designated for competitive procurement, and aid in ascertaining the source of difficulties associated with user experience reports.

14–203 Contract Administration Office.

(a) Except as otherwise specified in the contract, the contract administration office cognizant at a plant is responsible for the performance of Government procurement quality assurance actions. The contract administration office shall verify that the contractor has fulfilled contract quality requirements. It is the contract administration office responsibility to develop and apply effective and efficient procedures for Government procurement quality assurance. The contract administration office shall perform specific Government inspection actions when these actions are required in writing by the purchasing office. In implementing written Government inspection instructions, the contract administration office shall review these instructions and when appropriate, make recommendations to the purchasing office for their improvement in terms of both technical effectiveness and cost, particularly with respect to the utilization of Department of Defense personnel, equipment, and facilities. Written Government inspection instructions shall be continued on schedule as prescribed until the recommendation has been acted upon. The purchasing office is obligated to take appropriate action on such recommendation.

(b) The contract administration office shall report to the purchasing office any observed deficiencies in design or technical requirements, including contract quality requirements, and recommend necessary changes to the contract, specifications, or other requirements which will provide more effective operations or eliminate unnecessary costs.

PROCUREMENT QUALITY ASSURANCE

Part 3—Contract Provisions

14–301 Quality Assurance Clauses.

(a) The appropriate clauses referenced in 14–302 through 14–304 shall be inserted in contracts other than those entered into by use of DD Form 1155, Order for Supplies and Services/Request for Quotations (see Section III, Part 6).

(b) In purchases made by use of DD Form 1155 there is a requirement for the contractor to perform inspection; however, the nature of the item may make it desirable in exceptional cases to include other clauses listed in 14–302 through 14–304.

14–302 Standard Inspection Clauses. Where inspection is sufficient to assure that the supplies and services conform to contract requirements (see 14–101.2), the appropriate standard inspection clause prescribed in the listing below shall be inserted in the contract:

(i) 7–103.24 and 7–103.5(a), (b) or (c);
(ii) 7–203.5(a);
(iii) 7–302.4(a) or (b);
(iv) 7–402.5(a)(1) or (3);
(v) 7–402.5(b);
(vi) 7–602.10(a);
(vii) 7–602.11;
(viii) 7–702.6;
(ix) 7–703.6;
(x) 7–704.8;
(xi) 7–901.21; or
(xii) 7–1902.4 or 7–1909.5.

14–303 Inspection System Requirements. When the technical requirements of the contract are such as to require control of quality by in-process as well as final end item inspection, including control of such elements of the manufacturing process as measuring and testing equipment, drawings and changes, inspection, documentation, and records, the appropriate inspection system clause listed below, referencing the latest revision of MIL-I–45208, shall be used:

(i) 7–103.5(a), (b) or (c); 7–103.24 and 7–104.33;
(ii) 7–203.5(a) and (b);
(iii) 7–302.4(a) or (b) and (c);
(iv) 7–402.5(a)(1) or (3) and (c);
(v) 7–402.5(b) and (c);
(vi) 7–602.10(a) and (b);
(vii) 7–703.44; or
(viii) 7–901.21 and 7–901.25.

14–304 Quality Program Requirements.

(a) When the technical requirements of the contract are such as to require control of work operations, in-process controls, inspections and tests, as well as attention to other factors (*e.g.*, organization, planning, work instructions, documentation control, advanced metrology), the appropriate clause listed below, referencing the latest revision of MIL-Q–9858, shall be used. This paragraph does not apply to construction contracts.

(i) 7–103.5(a), (b) or (c); 7–103.24 and 7–104.28;

(ii) 7–203.5(a) and 7–204.10;

(iii) 7–302.4(a) or (b) and 7–303.15;

(iv) 7–402.5(a)(1) or (3) and 7–403.15;

(v) 7–402.5(b) and 7–403.15; or

(vi) 7–901.21 and 7–901.26.

(b) The contracting officer may delete nonapplicable portions of MIL-Q–9858 in contracts for material maintenance.

14–305 Places of Performance of Government Procurement Quality Assurance Actions.

14–305.1 *General.* Each contract shall designate the place or places where the Government reserves the right to perform those procurement quality assurance actions that it considers necessary to determine that supplies and services conform to contract requirements. Where the contract provides for Government procurement quality assurance actions at source, the place or places designated for such actions may not be changed without authorization of the contracting officer.

14–305.2 *Government Procurement Quality Assurance at Source.*

(a) When a contract requires the contractor to establish and maintain an inspection system or a quality program in accordance with 14–101.3 or 14–101.4, Government procurement quality assurance actions generally shall be performed at source.

(b) In addition to (a) above, Government procurement quality assurance actions shall be performed at source where:

(i) performance of such actions at any other point would require uneconomical disassembly or destructive testing;

(ii) special instruments, gauges, or facilities required for performance of such actions are available only at source;

(iii) performance of such actions at any other point would destroy or require the replacement of costly special packing and packaging;

(iv) Government procurement quality assurance during performance is essential; or

(v) supplies are destined for points of embarkation for overseas shipment (except as provided in 3–606.2, 14–305.3(b), and 14–306(c)).

(c) Where the contract provides for the performance of Government procurement quality assurance actions at source, these actions shall be taken at such times and places (including any stage in the manufacturing process at both the contractor's and his subcontractor's plants) as may be necessary to determine conformance to contract requirements. In the event that it is in the best interest of the Government to authorize shipment before all Government procurement quality assurance actions can be taken at source, the contract shall be modified to

the extent appropriate prior to shipment, if delivery is f.o.b. origin, (i) to make the delivery term f.o.b. destination or otherwise to make the contractor responsible for risk of loss or damage in transit, and (ii) where delivery remains f.o.b. origin, to require the contractor to reimburse the Government for the cost of shipping and other expenses incurred by the Government in the event of rejection at destination.

14–305.3 *Government Procurement Quality Assurance at Destination.*

(a) Government procurement quality assurance actions that can be performed at destination are normally limited to inspection of supplies. For many procurements, such inspection by the Government is sufficient. Supplies shall be inspected by the Government at destination when:

(i) they are purchased "off-the-shelf" and do not require technical inspection or no direct contract quality requirement is specified (14–101.5);

(ii) necessary testing equipment is located only at destination;

(iii) perishable subsistence supplies are purchased within the United States, except that perishable subsistence supplies destined for overseas shipment will normally be inspected for condition and quantity at points of embarkation;

(iv) brand name items are purchased for authorized resale, except that where supplies are destined for direct overseas shipment, inspection (and acceptance) will be made by the contracting officer or the official charged with such responsibility on the basis of a tally sheet evidencing receipt of shipment signed by the port transportation officer or other designated official at the transshipment point; or

(v) otherwise determined to be in the best interest of the Government.

(b) In no event shall a contract provide for Government inspection at a port of embarkation when the supplies are destined for overseas shipment, unless the contracting officer first determines that inspection functions can be provided at such destination. Similarly, overseas inspection shall not be required for supplies shipped from the United States except in unusual circumstances—as, for example, where inspection overseas is essential in conjunction with installation, operation, or other use of the supplies or equipment—and then only when the contracting officer first determines that inspection can be performed, or makes necessary arrangements for its performance, overseas.

14–306 Acceptance of Supplies or Services.

(a) Acceptance of supplies or services is the responsibility of the activity to which the function is assigned by the purchasing office. When a Government activity uses services of another Government activity or department for the purpose of acceptance, acceptance by the other activity or department is binding upon the activity for which the services are performed. Unless there are valid reasons to the contrary, acceptance shall be at origin (see 19–104).

(b) Depending upon the provisions of the contract, acceptance may be effected prior to, at the time of, or after delivery. Acceptance shall ordinarily be evidenced by execution of an acceptance certificate on the applicable inspection and receiving report form (DD Form 250, DD Form 1155, or Standard Form 44). When acceptance is accomplished at a point other than destination, supplies can-

Part 4—Distribution of Procurement Documents

20–401 Distribution of Procurement Documents.

(a) Except as provided in (f) below, the basic contract and all modifications thereto shall receive the same distribution.

(b) The contracting officer executing a contract or modification is responsible for complete distribution of the document within ten working days after execution. The purchasing office shall, upon assignment of the contract, furnish the contract administration office the contract distribution list and shall provide changes to the list as they occur.

(c) Except as provided in this paragraph and in (d)(i)(C) below, the procuring contracting officer shall maintain the original executed procurement document in the official contract file. The original of each modification executed by the ACO or TCO shall be provided to the PCO. Unless otherwise directed by the Department concerned, the original executed copies of orders under Basic Ordering Agreements (3–410.2) and the original executed provisioning orders (4–302.2) shall be maintained by the office issuing the orders.

(d) Except as provided in (f) below, copies of contracts (including agreements) and modifications shall be distributed as specified below:

(i) one signed copy or one reproduced copy of the signed contract and each modification thereto to:

(A) the contractor (this copy shall be stamped "Duplicate Original");

(B) the contract administration office;

(C) the payment office, except the original executed order and, as required by Departmental regulations, additional copies of a purchase order for open market purchases of $2,500 or less, delivery order(s), and Federal Supply Schedule orders, and each modification thereto shall be distributed to the payment office. For those assigned to DCAS, only the original executed order is required which shall be sent directly to the DCAS payment office (not with the CAO copies);

(D) each accounting and finance office (funding office) whose funds are cited in the contract;

(ii) in addition to the distribution in (i) above, additional copies shall be distributed as follows:

(A) four copies to the contract administration office (distribution shall be effected simultaneously with the copy furnished in (d)(i)(B) above;

(B) one copy to each consignee indicated in the contract (a transshipping terminal is not a consignee);

(C) one copy to the appropriate transportation office when required by 19–402 and additional copies as required by Departmental regulations;

(D) ten copies to the MIPR initiating activity in the case of coordinated procurement;

(E) two copies directly to the contract administration office cognizant of each manufacturing location where contract administration services will be required (see DoD Directory of Contract Administration Services Components 4105.59H), when administration of the contract is performed at other than the place of manufacture;

(F) one copy of each of the following type contracts and of each modification thereto to the appropriate Defense Contract Audit Agency (DCAA) field audit office (listed in the DCAA Directory—Headquarters and Field Offices):

(I) cost reimbursement; time and materials, or labor-hour contract;

(II) fixed price contract with redetermination, incentive, economic price adjustment or cost allowability provisions;

(III) any other contract which requires audit service

(if there is a question as to the appropriate DCAA field audit office, contracting officers may request the assistance of the DCAA procurement liaison auditor or the nearest DCAA field audit office); and

(G) one copy to the CAO ADP point, except when the DODAAD code (see DoD Directory 4105.59H) is the same as that of either the CAO or payment office.

(e) When a payment office is added to an existing contract by modification, a copy of the basic contract and prior modifications shall be furnished to such office. When a contract administration office, an accounting and finance office (funding office), a consignee or other activity is added by a modification, the contracting officer shall determine the extent to which each activity is concerned with the basic contract and modifications and make distribution accordingly.

(f) Distribution of modifications issued pursuant to 20–204.3(a)(ii)(B) and 20–204.4(b)(ii) may be limited to the following:

(i) Contractor;

(ii) Receiving Activity;

(iii) Contract Administration Office;

(iv) Payment Office;

(v) CAO ADP point in accordance with (d)(ii)(G) above.

(g) *Reserved.*

(h) When the purchasing office retains responsibility for administration of a contract containing the Cost Accounting Standards clause (7–104.83(a)), one copy of the contract shall be forwarded to the Contract Administration Office (Attn: ACO) cognizant of the contractor's facility (see DoD Directory 4105.59H). The following notation will be inserted in bold print on the face of the contract: **"FOR COST ACCOUNTING STANDARDS ADMINISTRATION ONLY".** (See 3–1208 (c) for contracts at facilities under the cognizance of a non- DoD organization.)

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[EXHIBIT 12]

STATISTICAL BREAKDOWN OF RESOLVED AND UNRESOLVED REPORTED CASES OF CAS NONCOMPLIANCES [Supplied by DoD]

During the hearing on Cost Accounting Standards (CAS) held on August 20, 1975, Dr. Bennett was requested to supply information as to the status of the CAS noncompliances we reported to the CAS Board on May 1, 1975. That report covered calendar year 1974 and is in compliance with the Board's requirements. Our May 1 report showed 423 cases of noncompliance with Cost Accounting Standards and 90 additional noncompliances with contractors' disclosure statements—a total of 513. We have since learned that the total should be revised to 506 due to errors in reporting.

Of the 506 noncompliances reported, 276 were discovered on proposals submitted by contractors. The remaining 230 involved existing contracts. We have determined that 189 of the proposal noncompliances have been resolved, but we have not attempted to determine the cost recovery because:

1. Until a proposal is accepted and a contract is awarded, expenditures are not made and there is no cost to recover.
2. Correction of the proposal to eliminate the noncompliance might increase or decrease the proposal price, but the actual effect on the final negotiated price would be difficult to establish and separate from the effect of other negotiable factors.
3. Very often the proposal is not accepted and award is to another contractor.

Although there are 87 proposal noncompliances that are not reported as settled we do not consider it likely that many are still open. Our reporting system presently does not provide for reporting when these cases are settled since they must be resolved, with rare exception, prior to contract placement. More importantly, no action can be taken on proposals that are rejected and it is likely that many of the open cases are in this category.

Of the 230 noncompliances involving existing contracts our review shows that 177 have been resolved leaving 53 cases still open. Only 6 of the 177 cases had a material impact on contract costs resulting in recovery of $163,296 by the DoD. No cost impact information is available for the 53 open cases since they are still not settled.

[EXHIBIT 13]

COMMENTS ON INFORMATION SUBMITTED BY DEPARTMENT OF DEFENSE IN REQUEST FOR WAIVER

[By U.S. Steel Corporation]

1. The list of five specified subcontracts involved in the Department of Defense request included two subcontracts, covering 11 shipsets of Air Flasks, with the following statement:

"Both of these proposed subcontracts have been unconditionally refused by United States Steel pending a satisfactory resolution of the CAS problem."

The facts of the matter are that the design features necessary for order acceptance are still being worked out by Electric Boat. These orders are not formally acknowledged pending finalization of detailed specifications. Preliminary design drawings of the end fittings were received from Electric Boat July 23, 1975, from which final drawings must be prepared and submitted to Electric Boat for approval, and orientation of the fittings in the flasks has not been resolved by Electric Boat. Revised design of the top and bottom assembly must also be finalized and entered into the specifications.

Meanwhile, the pipe was ordered and received for 3 complete shipsets at U.S. Steel's fabricating plant (Christy Park Works); the pipe for three additional shipsets was ordered from the U.S. Steel producing mill; and we have been endeavoring to arrange the mill rolling schedule to provide the pipe for 3 more shipsets before the end of this year. Similarly, orders were placed with Edgewater Steel Corporation for the foundation rings, bearing block rings and skirts for all eleven shipsets. While the first shipset was requested from Electric Boat by February 1, 1976, we scheduled production and shipment of the first three finished shipsets by the end of this year. Clearly, we took no action

to hold these defense products 'hostage", as our procedure of requesting the waiver of cost accounting standards has recently been characterized.

2. With respect to the third subcontract listed in the waiver request, which is for 22 Toroid Rings for the SN 688 submarines (i.e., eleven shipsets), the Department of Defense acknowledged that there has been "some performance", which would imply something less than full performance. This subcontract called for staggered deliveries starting with two rings in April, 1975, and four more from August to December, 1975; four rings in the year 1976; and the remaining twelve rings in 1977 and 1978. The first two rings were promised for April, 1975 and were shipped on schedule, which of course is actually full performance through July.

Steel for the remaining four rings scheduled this year was produced and shipped to our subcontractor, the Chicago Bridge and Iron Corporation, for fabrication into these rings. The schedule for completion of these four rings has been under continuing renegotiation, so as to accommodate Electric Boat's recent request to advance a December delivery to shipment prior to one previously scheduled for August. Thus the facts are that we have been continuing our endeavors to improve deliveries for the customer—not cut them off to force a waiver of the cost accounting standards. We understand that Chicago Bridge and Iron directly subcontracted with Electric Boat for fabrication of the rings for the lead Trident submarine, whereas the Department of Defense waiver request noted only that this subcontractor "... has refused to perform this work for the other producers of HY–80 steel or *any organization other than United States Steel.*" (Underline added)

3. The remaining two subcontracts listed in the waiver request were for HY–80 plate. The smallest of the two orders ($141,588 of miscellaneous plate items for the lead Trident submarine) was acknowledged to be completed. The larger of the two orders covers 680 tons of 5" thick plates for Transition Rings. These rings, in their assembled form, adjoin the aforementioned toroid rings in the eleven SN 688 submarine hull structures. Electric Boat subcontracted with Newport News Shipbuilding and Drydock Co., for the fabrication of these rings. Since the initial toroid ring shipments were scheduled for April, 1975, shipment of the transition ring plates for Newport News fabrication of the initial transition ring shipset was made several months earlier. Mill orders for the follow-on plate requirements for succeeding submarines were also entered, production is in process and some was recently shipped. However, the Department of Defense waiver request commented that "... Electric Boat does not know when United States Steel will resume deliveries."

4. The Department of Defense request for waiver stated:

"No other source is available to satisfy the Government's needs on a timely basis for HY–80 steel plate. The same is true for toroid rings and the air flasks, both of which are made from HY–80 steel."

Actually the air flasks for the SN 688 submarine are made from the same commercial grade of steel as our Chrome-Moly P–22 pipe; not HY–80, which is a Nickel-Chrome-Moly steel produced to different mechanical property specifications. With further procurement of air flasks for the submarine program yet to come, we would doubt that the other bidder for SN 688 submarine air flasks (Taylor Forge Company) is the only potential alternate for USS Christy Park production of these items, just as the capability for production of bomb bodies in the 1960's was developed by a number of companies.

With respect to HY–80 plate, U.S. Steel has not been the sole source for supplying the Government's needs for this product, and we find it difficult to understand the contention that this product cannot now be obtained from the other existing sources particularly under present conditions of generally depressed demand and unemployment. With respect to toroid rings, past and recent history suggests a variety of multiple source opportunities for procurement of these fabricated products. U.S. Steel could supply the fabricators with some, all, or part of the HY–80 steel required—however this goes in competitive bidding—just as we are prepared to compete with the existing and potential suppliers for all other HY–80 plates needed for the submarine program.

5. The Department of Defense request for waiver included a number of representation and allegations of illegal pricing and non-compliance with the 1962 Truth in Negotiations Act. As noted in the Statement to which this is appended, proof of U.S. Steel non-compliance with the applicable laws and regulations has been conspicuously lacking, and the only instance in which any of the allega-

tions cited by the Department of Defense have been brought to litigation is in a suit presently pending that relates to compliance with a 1951 consent order issued by the Federal Trade Commission.

The Department of Defense request for waiver included allegation that since enactment of the Truth in Negotiations Act "... there has been a continuing problem involving the inability of the Navy and its prime contractors to obtain cost or pricing data from United States Steel Corporation ...". There was no mention of the facts of the matter, which are as follows:

a. Prior to 1965, the Department of Defense purchased HY–80 by advertised procurement, which by law precluded the request for cost or pricing data.

b. In late 1964, the Navy adopted a GAO recommendation to negotiate HY–80 contracts. U.S. Steel received its first solicitation under the new policy at the close of 1964 and promptly responded with submission of the costs required, and thereafter continued to submit costs as required for HY–80 negotiated contract pricing proposals.

c. Although the waiver request further noted a 1972 report of "continuation of the refusals by Unted States Steel" (to supply costs) the facts are that U.S. Steel consistently submitted its costs for negotiated HY–80 contracts whenever required to do so under the law. We made a number of cost submissions to the contracting officers involved and to the Defense Contract Audit Agency for negotiated subcontracts over the period that HY–80 procurement were negotiated, commencing at the end of 1964 and continuing through early 1968.

d. In 1968 the Defense Industrial Supply Center (Defense Supply Agency) decided that adequate competition had been clearly established in the procurement of HY–80 and HY–100 steel, and since then has purchased the plates by advertised procurement which eliminated the requirements for submitting cost data. In fact, we are presently in the process of developing a bid to be submitted by August 26, 1975, in response to an advertised solicitation by this government agency for 144 tons of HY–80 plate.

[EXHIBIT 14]

AUGUST 7, 1975.

D. H. PAINTER,
Director of Procurement, Electric Boat Division, EBOAT ADM GRON, Groton, Conn.

Re your telegraph of August 1. This morning we met with Elmer B. Staats, Chairman of the Cost Accounting Standards Board, and members of his staff, with regard to its denial of our request. We are advised there will be a further meeting to seek a solution to this problem satisfactory to all concerned.

You may be assured that there will be no delay in meeting our delivery promises on your orders on our books. We would suggest your technical representatives advise us as promptly as possible final specifications to apply to the orders you have indicated you wish to place with us for the flasks for your submarine program so that they may be processed to meet your delivery requirements.

E. B. SPEER,
Chairman, United States Steel Corporation.

[EXHIBIT 15]

UNITED STATES STEEL, CORP.,
Pittsburgh, Pa., August 15, 1975.

MR. ARTHUR SCHOENHAUT,
Executive Secretary, Cost Accounting Standards Board, Washington, D.C.

DEAR MR. SCHOENHAUT: Based upon our extensive discussions with you and the several members of your staff and the DCAA audit representatives in our meetings here in Pittsburgh during the past two days, we are presently of the opinion that our long established standard cost accounting system, as presently constituted and structured, provides the basis for compliance with Cost Accounting Standards at any of our affected profit centers performing contracts or subcontracts to which such standards are applicable and not otherwise excluded or exempted from compliance by applicable law or regulations.

We intend to comply with applicable requirements of the Cost Accounting Standards Board in any appropriate instance where statutory or regulatory exemptions are not available in connection with contracts or subcontracts accepted by U.S. Steel. As we have previously informed you, U.S. Steel has assured Electric Boat that there will be no delay in meeting our delivery promises because of any possible problems in working out the applicability of Cost Accounting Standards.

We appreciate the time and effort expended by you and your associates in meeting with us here in Pittsburgh the last two days and also in our earlier meetings in Washington. We believe our discussions have been very helpful in our having a better understanding of the requirements of these standards and to the satisfactory resolution of the matter.

Very truly yours,

BRACY D. SMITH,
Vice President and Comptroller.

EXHIBIT 16

UNITED STATES STEEL CORPORATION
Eastern Steel Division
Boston District Sales Office

June 5, 1974

Electric Boat Division
General Dynamics Corporation
Dept. 630--Procurement
Groton, Connecticut 06340

Attention: Mr. J. E. Riordan
Chief of Procurement, Special Programs

Gentlemen:

Subject: Purchase Order K7039-801

We have reviewed your letter of May 14, 1974, and have subsequently received your purchase order K7039-801. We bid these items based on the U.S. Steel Conditions of Sale with no requirement for the filing of a disclosure statement or the applicability for Cost Accounting Standards. We are unable to agree to accept the applicability of the disclosure statement or the Cost Accounting Standards. Since the avoidance of these requirements is totally within your control in subcontracting, as stated in your letter, it was anticipated that you would take such steps.

As you have indicated that these are now mandatory requirements for this order and since we can not agree to the requirements, we can not accept or enter this order at this time. Any order must be based exclusively on the U.S. Steel Conditions of Sale. If you do not desire to do business on this basis, please withdraw your purchase order. If we do not hear from you within 10 days we will assume that you desire to do business exclusively on the U.S. Steel Conditions, and we will accordingly enter the order on that basis.

Very truly yours,

UNITED STATES STEEL CORPORATION

Richard W. Ray
Service Representative

RWR:ae

EXHIBIT 17

U. S. Steel Corporation Shipments vs. Mill Schedule on Electric Boat Orders — Exhibit E

For purposes of continuity, in responding to the above matter, we have developed comparisons between shipments and mill schedule for the same group of orders which were reviewed with Electric Boat on August 27, 1975 for determination of cost accounting standards' applicability. This affected group is comprised of 20 orders, including three proposed orders for air flasks which have not yet been finalized. The comparison for the remaining 17 orders appears below.

The data under the heading "Mill Schedule" represent the shipment schedule developed at the time of order entry and acknowledgment. The actual tonnages shipped are listed under the heading "Tons Shipped". The differences result from many factors including revisions in the schedule to accommodate the customer's needs for advancing or deferring shipments, production problems in the producing plant such as bad heats, equipment breakdowns, rolling delays, pieces failing to pass inspection, fuel shortages, strikes such as the coal miners' walkout in late 1974, and lack of scheduling flexibility in a peak steel demand period.

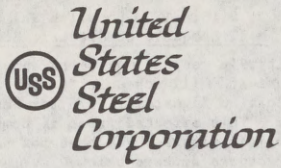
While some percentage of shipments were delayed by reason of the above factors, the existence or extent of late shipments cannot be established simply by comparing the columns headed "Tons Shipped" with the column headed "Mill Schedule". Our tracking system does not currently provide periodic order status and determination of whether a particular item actually was late would require a manual examination and analysis not only of each order, but of individual items within each order as to any changes and reasons therefor. Each order is typically made up of many individual items. One order totaling 4,100 tons, for example, was made up of 2,900 items. The magnitude of this task of manually recreating the entire history of schedule revisions precludes its completion in any reasonable period of time.

Production problems and the necessary rescheduling of output are normal occurrences in a process such as steel manufacturing and affect schedules for commercial customers as well as government prime or subcontracts.

The table demonstrates a history of uninterrupted shipments of materials required for the defense effort throughout the period when our waiver request was being processed. From May 1974 through July 1975 shipments averaged 457 tons per month. We emphasize once again that delivery delays and rescheduling resulted from the type occurrences described above and did not in any way result from U. S. Steel's request for a waiver from cost accounting standards.

	Mill Schedule		Tons Shipped											
Year	Month	Tons	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
1974	Jan		104											
	Feb	628		316										
	Mar	771			907									
	Apr	469				260								
	May	666					339							
	June	422						300						
	July	657							586					
	Aug	272								268				
	Sept	136									191			
	Oct	267										517		
	Nov	406											435	
	Dec	1,074												657
1974	Total	5,768												4,880
1975	Jan	67	439											
	Feb	555		238										
	Mar	736			916									
	Apr	228				332								
	May	509					655							
	June	107						567						
	July	285							421					
	Aug	65								176				
1975	To Date	2,552								3,744				

EXHIBIT 18



WILLIAM G. WHYTE
VICE PRESIDENT

1625 K STREET, N. W.
WASHINGTON, D. C. 20006

September 5, 1975

The Honorable
William Proxmire
Vice Chairman
Joint Committee on Defense Production
Congress of the United States
Senate Office Building Annex, A-419
110 D Street, N.E.
Washington, D. C. 20510

Dear Senator Proxmire:

As requested during Mr. David M. Roderick's appearance before the Joint Committee on Defense Production on August 21, 1975, enclosed are additional reports for the record concerning (1) Cost Accounting Standards' applicability to the designated Electric Boat purchase orders referred to in such proceedings and (2) U. S. Steel's Federal government sales during 1974, totaling $47.2 million. Excluding bomb body and shell contracts, our Christy Park defense related business during 1974 totaled $3.4 million. These documents have been marked Exhibits "D" and "F" respectively and are submitted for inclusion in the record as attachments to Mr. Roderick's transcript of remarks to the Committee. We would be pleased to have data regarding U. S. Steel's Federal government sales supplied for 1975 should that information subsequently be required for Committee purposes.

We are proceeding with development of the requested report concerning U. S. Steel's delivery performance under Electric Boat orders during the period concurrent with the pendency of U. S. Steel's waiver request, and will furnish such report for inclusion in the record promptly upon our completion of such report which will be marked Exhibit "E".

We, of course, also intend to submit for the record our comments regarding the Navy's chronology of alleged problems with U. S. Steel, and appreciate your consideration in according U. S. Steel the opportunity to present its position in such regard.

Sincerely,

Wm. G. Whyte

Enclosure

Exhibit D

Electric Boat Division General Dynamics Corporation
Purchase Orders re Applicability of Cost Accounting Standards

On August 27, 1975 representatives of United States Steel Corporation (U. S. Steel) and Electric Boat Division, General Dynamics Corporation (Electric Boat) held a meeting at Electric Boat's Groton, Connecticut offices for purpose of determining applicability of Cost Accounting Standards and resolution of certain other matters relative to 20 outstanding Electric Boat purchase orders with U. S. Steel involving their procurement of steel materials commonly known as air cylinders (or flasks), toroid rings, HY-80 plates and certain other items for the Navy submarine program. The orders involved (and which were considered in such regard) included 3 proposed orders for air cylinders which were in the process of being finalized as to specifications and price.

Based upon the results of such meeting, United States Steel Corporation will accept and comply with Cost Accounting Standards on the following Electric Boat purchase orders and will comply with Truth In Negotiations Act requirements as applicable to such orders with respect to providing certified cost or pricing data. The orders to which the above indicated requirements shall apply are:

E.B. Purchase Order No.	Steel Material
K5077-701	Air Flasks
K5235-102	"
K7253-501	"
K7039-801	HY-80 Plates
K5065-700	"
K7176-801	"
J7248-801	"
K7267-801	"
J7073-801	"
A7013-803	"
K5056-700	Toroid Rings

For any of the above orders which are presently unacknowledged, U. S. Steel will furnish Electric Boat our signed acknowledgment form containing an express statement of U. S. Steel's acceptance of Cost Accounting Standards on such orders and of compliance with Truth In Negotiations Act requirements as applicable thereto. With respect to any such previously acknowledged orders, we will provide a supplementary signed acknowledgment form for purpose of confirming our express acceptance of such requirements.

From review of information available during such meeting, our respective representatives were of the opinion that the remaining Electric Boat orders in question (as enumerated below) involved subcontracts of the type which were not subject to the foregoing requirements by applicable law or regulations.

For example, 3 of the remaining orders involved procurement of basically commercial grades of carbon plate material of a type which the parties believed qualify for catalog price exemption under the governing law and regulations. Electric Boat requested and U. S. Steel agreed to submit Department of Defense Form DD633-7 to implement an exemption request for these particular orders, as follows:

63-923 O - 76 - 14

E.B. Purchase Order No.	Steel Material
K6126-350	Carbon Plates
K7119-801	"
J611-350	"

The following orders as placed by Electric Boat were identified as involving purchase amounts under $100,000, which is below the requisite threshold level for applicability of the requirements in question. These particular orders are:

E.B. Purchase Order No.	Steel Material
K7234-803	HY-80 Plates
K7275-001	"

The following orders were identified by Electric Boat as involving their procurement of material for inventory replacement not specifically designated for use on any specific government contract, which were accordingly considered as constituting orders not covered by the requirements in question:

E.B. Purchase Order No.	Steel Material
K325-609	HY-80 Plates
K219-605	"
K7221-803	"
A129-607	"

In the event it is appropriately determined that any of the above enumerated orders are deemed subject to CAS or other applicable requirements, U. S. Steel will, of course, comply.

U. S. Steel Corporation
Government Sales*

1974	$47,210,000

*Based on prime and subcontract renegotiable sales which are predominantly defense business.

SEPTEMBER 29, 1975.

Mr. DAVID M. RODERICK,
President, United States Steel Corp., 600 Grant Street,
Pittsburgh, Pa.

DEAR MR. RODERICK: I have received your firm's letter dated September 5, 1975, signed by William G. Whyte, Vice President of the U.S. Steel Corporation, furnishing additional information in elaboration of your testimony before the Joint Committee on Defense Production on August 21, 1975.

Exhibit D thereto states that U.S. Steel will accept and comply with Cost Accounting Standards on eleven of twenty orders discussed with Electric Boat; that you question whether or not the law requires Cost Accounting Standards on the remaining nine orders; but that, if it is determined that any of these nine orders are subject to Cost Accounting Standards or other applicable requirements, U.S. Steel will comply.

I am encouraged by the position U.S. Steel has taken in unequivocally accepting Cost Accounting Standards requirements and trust that U.S. Steel will, as a matter of policy, continue to accept these requirements in future Government contracts and subcontracts.

Exhibit D also states that U.S. Steel will comply with Truth-in-Negotiations Act requirements, but adds the words "as applicable to such orders." Would you please give me your unqualified assurance that U.S. Steel will accept and comply with the Truth-in-Negotiations Act requirements as well as Cost Accounting Standards for these non-competitive orders?

I am also concerned about the U.S. Steel practice of "accepting" rather than signing contracts. As I understand the practice, a contractor such as Electric Boat sends U.S. Steel a contract which includes or specifically cites buyer's terms and conditions, including mandatory government requirements. Rather than signing the contract or negotiating a resolution where there are differences, U.S. Steel sends back a "standard acknowledgement form" which confirms the order, but states:

"No terms or conditions other than those stated herein and no agreement or understanding, oral or written, in any way purporting to modify these terms and conditions shall be binding on Seller unless hereafter made in writing and signed by its authorized representative. Acceptance of the products hereunder shall constitute assent to these conditions and Seller hereby objects to and rejects any and all additional or different terms proposed by Buyer, whether contained in Buyer's purchasing or shipping release forms or elsewhere. All proposals, negotiations, and representations, if any, made prior and with reference hereto are merged herein."

Your company's practice of "accepting" rather than signing contracts raises the question of whether or not a legally-binding agreement immediately comes into being. This issue is further complicated by the above-quoted provision in your "standard acknowledgement form," which may, in fact, represent a counter-offer.

To clear up this matter, I would appreciate U.S. Steel Corporation's legal opinion on the attached questions.

I am not asking for an elaborate defense of the U.S. steel practice. Instead, I would like to have the requested legal opinion and your personal assurance that the company is dealing in good faith with the government and its contractors—and that you will evidence this good faith by signing unconditionally contracts containing the clauses required by law or regulation. Otherwise, there would persist in my mind the question of whether or not U.S. Steel is complying with all applicable laws and regulations required for government contracts.

I appreciate the cooperation you have evidenced so far in accepting Cost Accounting Standards requirements. I trust that you will continue in this vein with regard to the issues I have raised in this letter.

Sincerely,

WILLIAM PROXMIRE, *Vice Chairman.*

Attachment

QUESTIONS REGARDING U.S. STEEL'S ORDER ACKNOWLEDGEMENTS

1. Is U.S. Steel's standard acknowledgement form deemed to constitute a contract (when combined with buyer's order), a contract acceptance, a counter-offer, or merely a confirmation of receipt?

2. Do the terms and conditions in U.S. Steel's order acknowledgement form nullify any contradictory terms and conditions in the purchase order sent to U.S. Steel by the buyer?

3. Are terms or conditions included in the buyer's purchase order but not included in U.S. Steel's order acknowledgement form nullified?

4. Specifically, does the statement on the obverse of the standard acknowledgement form to the effect that the order is accepted "subject exclusively to the conditions of this acknowledgement including those on the reverse hereof" nullify any contradictory terms of stipulations stated or implied in the buyer's order?

5. What kind of written statement would U.S. Steel consider signing as meeting the requirements of condition 11 on the reverse of the standard acknowledgement form?

6. To the extent there are differences between the terms and conditions of the buyer's purchase order and the terms and conditions in U.S. Steel's standard acknowledgement form, would there be a legally binding contract during performance of the order and prior to delivery and acceptance of the goods?

7. If so, what terms and conditions would govern--the buyer's or U.S. Steel's -- and why?

8. What is the effect of condition 11 on required Cost Accounting Standards or Truth-in-Negotiations Act clauses?

9. What is the legal effect of the condition 11 statement that " All proposals, negotiations and representations, if any, made prior and with reference hereto are merged herein"?

10. What mechanism, legal or otherwise, if any exists to resolve differences between buyer's purchase order and U.S. Steel's standard order acknowledgement form?

11. The U.S. Steel's standard acknowledgement form appears to state in condition 11 that the firm has received an order and that receipt of the goods by the buyer constitutes agreement to U.S. Steel terms as set forth in the acknowledgement form. Do you agree? If not, what is your interpretation of this provision and why?

12. Condition 12 of U.S. Steel's standard acknowledgement form states:

"Any clause required to be included in a contract of this type by an applicable law or administrative regulation having the effect of law shall be deemed to be incorporated herein."

Does this language bar U.S. Steel from successfully contesting the applicability of any law or administrative regulation having the effect of law subsequent to U.S. Steel's acknowledgement of any given order?

13. Which condition--eleven, disclaiming terms or conditions not made in writing and signed by a company representative or twelve, deeming any legally required clause to be incorporated--is considered applicable to clauses required in government contracts and especially to the Cost Accounting Standards Act or the Truth-in-Negotiations Act clauses?

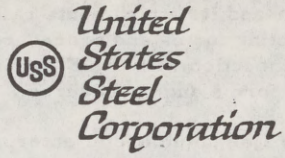
14. How does condition 12 incorporating any applicable law or administrative regulation having the effect of law in a "contract of this type" affect the statement in condition 11 that no terms or conditions are binding on seller unless made in writing and signed by seller's authorized representative? Is this not a circular process of accepting incorporation and disclaiming incorporation of clauses required by law? Does condition 11 nullify condition 12?

15. When condition 12 refers to a "contract of this type" is it referring to U.S. Steel's standard acknowledge-form?

16. If "acceptance" of a contract or a purchase order is deemed by U.S. Steel to be equivalent to signing a contract, then why does U.S. Steel not sign contracts?

17. How is either party able to administer a contract properly when there is no clear understanding at the outset as to which laws and regulations are applicable to the work in question? Is not this provision 12 itself sufficiently vague to raise questions regarding the overall enforceability of the contract?

18. Are all U.S. Steel customer orders accepted with the same standard acknowledgement form with the same terms and conditions? Are there customers with whom U.S. Steel negotiates terms and conditions or contracts on a different basis?



D. M. RODERICK
PRESIDENT

600 GRANT STREET
PITTSBURGH, PENNSYLVANIA 15230

November 11, 1975

The Honorable William Proxmire
United States Senate
Washington, D.C. 20510

Dear Senator Proxmire:

This will acknowledge your letter of September 29 in regard to application of the Cost Accounting Standards and the Truth-in-Negotiations Act requirements to the orders received by U. S. Steel from Electric Boat which were identified in the attachment to our Mr. Whyte's letter to you of September 5.

As indicated in your letter, the commitment in the referenced attachment was to comply with the Truth-in-Negotiations Act requirements "as applicable to such orders" and you have requested our "unqualified assurance" that U. S. Steel will accept and comply with the Truth-in-Negotiations Act requirements, as well as Cost Accounting Standards, for "these non-competitive orders."

As you are aware, by its own terms, the Truth-in-Negotiations Act does not apply to procurements of materials, inter alia, where the price negotiated is based on adequate price competition, or where the price is an established catalog or market price of commercial items which are sold to the public in substantial quantities. Our reference to "as applicable" had obvious reference to these exemptions, on the assumption that you did not intend a standard of compliance for U. S. Steel different from that established by Congress in the subject Act. This will inform you that no exemption under the Truth-in-Negotiations Act will be claimed for any of the Electric Boat orders identified in the above-mentioned attachment to Mr. Whyte's letter of September 5. I can assure you also that we will comply with the Truth-in-Negotiations Act with respect to any future orders which are not exempt under the statute.

Your letter and its attachments raise a number of questions regarding our contracting forms and procedures. The forms and procedures utilized in connection with the Electric Boat orders are our standard commercial forms and procedures.

Like any major commercial enterprise, U. S. Steel enters into thousands of commercial transactions every month, with hundreds of different customers. Price, delivery, warranty and other basic provisions governing these transactions must be clarified and established. Quite apart from problems such as efficient service, added costs and potentially illegal discrimination, it obviously would be totally impracticable for U. S. Steel, or its customers, to negotiate individual terms and conditions for each transaction. For these reasons standard procedures and terms and conditions of sale have been developed and are customarily utilized as a matter of practical necessity. However, when it is in the mutual best interest of both parties, for example when there are repetitive transactions under similar circumstances with a single customer, we may undertake to negotiate mutually acceptable terms and conditions applicable to such orders. As a matter of interest, we have been negotiating mutually acceptable terms and conditions with Electric Boat.

The U. S. Steel standard procedures and terms and conditions reflect our best judgment based upon long experience as to the optimum format to assure expeditious, fair and uniform dealing with our many customers, both large and small, and we believe the minimal difficulty and litigation we have experienced confirms these judgments. I think it is clear also that we could not afford commercially to utilize standard contract provisions which did not meet with general acceptance.

To be sure, we frequently encounter purchasing forms submitted by customers, which pose the type of questions enumerated in the attachments to your letter. In fact, as I am sure you are aware, while the Uniform Commercial Code, and particularly Section 2-207, is directed toward resolving the so-called "battle of the forms," many interesting legal questions remain and these have been the subject of much legal comment. For your possible interest, a list of relevant articles is attached.

I have discussed with our Law Department your request for "U. S. Steel Corporation's legal opinion on the attached questions." They point out that a legal opinion can be developed only in relation to all of the relevant facts of a particular transaction, and that the facts going to make up the type of situations envisaged by the questions you have asked may vary significantly from transaction to transaction. Further, of course, interpretations of the applicable law may vary, and legal opinions also may vary depending upon the state in which the questions were litigated. In view of these circumstances our lawyers do not believe it is possible to provide a meaningful response to the questions attached with your letter. However, they would be glad to discuss the above aspects or any of the questions with you or your designee. If you believe this would be helpful, I would suggest you directly contact Mr. Marion G. Heatwole, our General Counsel, to make appropriate arrangements. Mr. Heatwole's telephone number is (412) 433-1117.

Sincerely,

Attachment

LIST OF ARTICLES

Lipman, On Winning the Battle of the Forms: An Analysis of Section 2-207 of the Uniform Commercial Code, 24 Bus. Law 789 (1969)

Hawkland, The Buyer's Purchase Order Under The Uniform Commercial Code, The Practical Lawyer, Vol. II, No. 3, p. 25 (1965)

Davenport, How to Handle Sale of Goods: The Problem of Conflicting Purchase Orders and Acceptances and New Concepts in Contract Law, 19 Bus Law 75 (1963)

Weeks, "Battle of the Forms" Under the UCC, 52 ILL BJ 660 (1964)

Note, Contract Draftsmanship Under Article Two of the UCC, 112 U Pa L Rev 554 (1964)

Note, Nonconforming Acceptances Under Section 2-207 of the UCC: An End to the Battle of Forms, 30 U Chi L Rev 540 (1963)

Note, The UCC and Contract Law: Some Selected Problems, 105 U Pa L Rev 836, 853 (1957)

Note, Sales--Offeree's Response Materially Altering an Offer Solely to Offeror's Disadvantage Is an Acceptance Conditional on Offeree's Assent to the Additional Terms Under Section 2-207 of the UCC, 111 U Pa L Rev 132 (1962)

Murray, Intention over Terms: An exploration of U.C.C. §2-207 and New Section 60, Restatement of Contracts, 37 FORD. L. REV. 317, 332-34 (1969)

Note, Contracts: Sale of Goods: Acceptance of Offer: Additional or Different Terms: Section 2-207, UCC: Section 84-a, N.Y. Personal Property Law, 46 Cornell LQ 308, 316 (1961)

Note, UCC: Variation Between Offer and Acceptance under Section 2-207, 1962 Duke L J 613

Note, UCC Section 2-207 and the "Counter Offer": Acceptance Unlimited?, 57 NW L Rev 427, 480 (1962)

1 W. Hawkland, A Transactional Guide to the Uniform Commercial Code § 1.090303 (1964)

Murray, The Realism of Behaviorism Under the Uniform Commercial Code, 51 Ore. L. Rev. 269,285 (1972)

Phalan, Uniform Commercial Code - Sales - Inadvertent Acceptance of Buyers' Terms, 62 Dick. L. Rev. 171 (1958)

Resnick, Conflicting Boiler - Plate - Effect of the Uniform Commercial Code, 18 Bus. Law 401 (1963)

Tisdale, Impact of the Uniform Commercial Code on the Law of Contracts, 39 N.D. L. Rev. 7, 24 (1963)

Congress of the United States
JOINT COMMITTEE ON DEFENSE PRODUCTION
(CREATED PURSUANT TO PUBLIC LAW 774, 81ST CONGRESS)
WASHINGTON, D.C. 20510

December 16, 1975

Mr. David M. Roderick, President
United States Steel Corporation
600 Grant Street
Pittsburgh, Pennsylvania 15230

Dear Mr. Roderick:

This is in response to your letter of November 11, 1975.

I am pleased to have your assurance that no exemptions to the Truth-in-Negotiations Act will be claimed by U.S. Steel on the Electric Boat orders identified in our earlier correspondence. I also am encouraged by your commitment to comply with the Act on future orders. I remain concerned, however, that these commitments may be meaningless in view of U.S. Steel's practice of "accepting" contracts subject only to U.S. Steel's terms and conditions rather than signing contracts in which both parties agree to applicable terms and conditions. My letter of September 29th requested answers to a number of questions regarding the legal implications of the manner in which U.S. Steel enters contracts. My concern was that government contracts and subcontracts with U.S. Steel might be unenforceable since it seemed questionable that your practice resulted in a true meeting of the minds. If these contracts are unenforceable, I question the value of your commitments to accept contracts with Cost Accounting Standards and Truth-in-Negotiations requirements.

My letter afforded you the opportunity to reassure me on this simple issue--the legality and enforceability of contracts and subcontracts with U.S. Steel. Your

Your response declines to address the issue. Instead, you advise that your lawyers do not believe it is possible to provide a meaningful response to the questions because "a legal opinion can be developed only in relation to all the relevant facts of a particular transaction." Further, the lengthy justification of your practice as "commercially acceptable" does not seem to me to be relevant in the context of government procurement where buyers have an affirmative obligation to insure that certain requirements of federal law are enforced. Finally, the literature referred to in the attachment to your letter in connection with Section 2-207 of the Uniform Commercial Code only heightens my concern that contracts entered in accordance with your standard practice may be unenforceable.

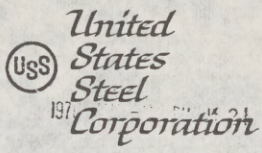
Since I believe it is crucial for the government to understand the contractual basis on which its work is being performed at U.S. Steel, and since your lawyers need a "particular transaction" to render a meaningful and definitive legal opinion, I would appreciate your addressing my questions in the context of any or all of the Electric Boat procurements which were the subject of our earlier hearings.

Of course, if you will give me your personal assurance that in selling to the government or its contractors U.S. Steel will contract on the basis of signed, bilateral agreements which contain the provisions required by applicable laws and regulations, the legal opinion would not be needed.

I would like to see this matter resolved promptly. Please advise me within two weeks of the date of this letter whether you will agree to contract in the future on the basis of bilateral contracts, signed by both parties and containing all provisions required by laws and regulations. If you are unwilling to provide this assurance, please furnish the legal analysis. In the absence of a satisfactory resolution of this problem, I intend to ask the help of the General Accounting Office in pursuing this matter and providing recommendations.

Sincerely,

William Proxmire
Vice-Chairman



D. M. RODERICK
PRESIDENT

600 GRANT STREET
PITTSBURGH, PENNSYLVANIA 15230

December 31, 1975

The Honorable William Proxmire
United States Senate
Washington, D.C. 20510

Dear Senator Proxmire:

This is in response to your letter dated December 16 which was not received here until December 22, 1975.

If I fully understand your position, you are concerned specifically that government contracts and subcontracts with United States Steel Corporation contain all of the provisions required by applicable laws and regulations and that such contracts are legally binding and enforceable. In your view, the use of "bilateral contracts, signed by both parties" would accomplish those objectives.

Our standard terms and conditions of sale expressly incorporate all clauses required to be included by applicable law or regulation, and I can, therefore, give you our unqualified assurance that all such provisions are included in our government contracts and subcontracts.

I can assure you also as to the legality and enforceability of contracts and subcontracts with U. S. Steel and to my knowledge we have never contended otherwise. Further, since the above-mentioned incorporation by reference provisions is part of our own standard terms and conditions, there can be no question but that clauses required to be included by law or applicable regulation will be part of each government contract or subcontract with U. S. Steel, and will be legally binding and enforceable.

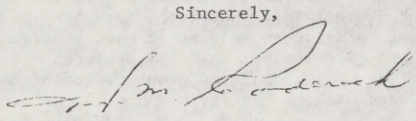
As to the routine use of signed bilateral contracts, United States Steel consistently strives to reduce costs and increase productivity. Two areas where we have experienced success have been reduction of unnecessary paperwork and reduction of inefficient utilization of personnel. If it were necessary for us to negotiate the terms and conditions of each sale, reduce the agreement to writing, and then have both parties formally sign the agreement, we would not only reduce our efficiency and productivity and increase paperwork, but we would greatly increase the risk of delay in production and delivery of

United States Steel Corporation

the products. From our experience, it has been extremely difficult and time consuming to negotiate final detailed agreement on terms and conditions and secure from both buyer and seller all required internal clearances in order that bilateral contracts can be signed. Pertinently, the Uniform Commercial Code not only does not require such a bilateral, signed contract, but it fully recognizes that commercial transactions for the purchase and sale of goods need not be on the basis of such a signed agreement by providing the mechanism for determining applicable terms and conditions if the parties have not both signed the same paper. Certainly, the Government Priorities System that controls the sale of urgently required controlled materials, such as steel products, would not permit the delays that would be encountered during the bilateral negotiation of each sales transaction. For these reasons, we trust you can appreciate our reluctance to agree to a program that requires a signed bilateral agreement in all situations, especially since all required clauses have been incorporated into the agreement. In this connection, as I earlier informed you, where there are repetitive ordering circumstances, we do attempt to negotiate mutually agreeable terms and conditions and have been negotiating with Electric Boat to this end.

I believe this letter provides the assurance you request with respect to our government contracts and subcontracts. If, however, any uncertainty remains, since these are essentially legal questions I again suggest that the matter be discussed by you or your designee with our lawyers, and that you directly contact Mr. Marion G. Heatwole, our General Counsel, to make appropriate arrangements.

Sincerely,



[Exhibit 19]

Chronology of Navy's Dealings With Steel Companies on Purchases of Specialty Steels

1947—HY 80 developed under Navy research program. U.S. Steel was first producer.

1951—The Federal Trade Commission issued a consent decree providing that U.S. Steel Corporation and other steel producers should cease certain collusive pricing practices, including the use of pricing formulas which produce identical delivered costs.

1960—Lukens and U.S. Steel started listing steel prices as part of their price catalogues.

1962—Truth-in-Negotiations Act passed.

1961–1964—The Navy Department sent a series of letters to the Federal Trade Commission reporting the receipt of identical bids from U.S. Steel and Lukens Steel on orders for HY 80 steel, a special steel used almost excusively on Navy ships. The two companies priced their offers in such a way that, when delivery costs to the shipyard are included, the prices from both are identical. The Navy receives no answer from the Federal Trade Commission.

January 28, 1965—The General Accounting Office issued a report stating that during the period 1960–1964, U.S. Steel and Lukens quoted identical prices for HY 80. The GAO also found that the Navy did not obtain cost and pricing data, as required by the Truth-in-Negotiations Act, on purchases of HY 80 steel. The GAO concluded that since the two suppliers quoted identical prices, there was not adequate competition on these procurements. The GAO recommended that the Navy obtain cost and pricing data on future steel procurements.

1965—The Navy promised the GAO that cost and pricing data would be obtained on future orders of HY 80 steel.

1965–1969—The Navy and its shipbuilders were unsuccessful in repeated attempts to obtain cost and pricing on procurements of HY 80 steel. U.S. Steel, Lukens Steel, Armco Steel, and Bethlehem Steel all refused to provide the data.

1967—The Defense Supply Agency, which also purchases HY 80 steel, reported to the GAO that it has obtained effective competition on purchases of the steel, and therefore it will not request cost and pricing data from steel suppliers.

December 1960–January 1970—[In two memoranda to the] is informed Commander, Naval Ship Systems Command, [Admiral Rickover reported] on the purchase of HY 80 and another specialty steel, HY 100 at Newport News Shipbuilding and Dry Dock Company. The steel suppliers quoted prices according to a formula which makes the delivered costs identical. Although the shipyard purchased several million dollars worth of specialty steels annually, it did not obtain cost data in accordance with the Truth-in-Negotiations. The Commander, Naval Ship Systems Command reported that he agrees with these ["basic facts" in Admiral Rickover's] reports. He directed a review of the situation and states that, in the future, the Navy will not consent to Newport News' steel procurements unless cost data have been obtained.

March 17, 1970—The Commander, Naval Material Command, reported that steel companies still refuse to provide cost data on Navy and Newport News purchase orders. He authorized the placement of purchase orders without cost data in order to meet emergency requirements.

April–May 1970—Newport News formally requested the steel companies to provide cost data on sales of HY 80 and HY 100 steel. The companies refused. They pointed out that the Defense Supply Agency determined in 1967 that cost data need not be furnished on its procurements, and thus the Navy was in no position to request such data on Navy procurements.

August 18, 1970—[Senator Proxmire asked the] GAO asked to investigate procurement practices and cost controls at private shipyards which have large Navy ship construction contracts. He specifically requested a review of the shipyard's implementation of the Truth-in-Negotiations Act.

October 13, 1970—[Admiral Rickover wrote to the] Commander, Naval Ship Systems Command, is urged to take prompt action because [stating that] there has been no change in the situation in the 10 months since his reports of January, 1970. [were prepared, and urging prompt action.]

November 25, 1970—The Assistant Secretary of the Navy requested Department of Defense assistance in obtaining cost and pricing data on procurements of HY 80 and HY 100 steel.

February 10, 1971—The Assistant Deputy Secretary of Defense replied that the Navy's problems in dealing with the steel companies should be resolved by the Navy. The Department of Defense will not become involved.

March 12, 1971—The Navy General Counsel wrote to the Federal Trade Commission. He stated that Navy shipbuilders are still receiving identical bids from suppliers of specialty steels. He requested an answer to the Navy's letters to the FTC in 1961–64.

March 25, 1971—The Assistant Secretary of the Navy again wrote the Department of Defense, pointing out again that the Navy does not have enough economic leverage to convince the steel companies to comply with the law.

March 25, 1971—The Navy asked the General Accounting Office to audit the steel companies' production costs for HY–80 and HY–100 steel.

April 9, 1971—The Assistant Secretary of Defense replied to the Navy. He reiterates that the steel problem is the Navy's problem. However, he agreed to talk it over with Navy officials when he gets a chance.

December 1917—FTC began an investigation into charges of collusive bidding practices of HY–80 and HY–100.

July 7, 1972—GAO report verified findings of 1969–70 Rickover reports as well as the findings of 1965 GAO report.

June 18, 1974—FTC charges Lukens and U.S. Steel with violating a 1951 FTC order prohibiting them from price fixing.

EXHIBIT 20

Congress of the United States
JOINT COMMITTEE ON DEFENSE PRODUCTION
(CREATED PURSUANT TO PUBLIC LAW 774, 81ST CONGRESS)
WASHINGTON, D.C. 20510

September 5, 1975

Hon. John Bennett
Acting Assistant Secretary of Defense (I & L)
3E808 The Pentagon
Washington, D. C. 20301

Dear Dr. Bennett:

I wish to thank you for your appearance last month before the Joint Committee on Defense Production. Your testimony will be most helpful to the Committee in its efforts to ensure the fullest compliance with the Cost Accounting Standards provisions of the Defense Production Act.

There are, however, a number of issues which were raised in your statement and in your testimony and which time did not permit us to discuss at length. I have developed a list of questions on these subjects and I would appreciate your earliest response to these queries so that we may include them in the record of the hearings.

In addition, I would appreciate your providing, or obtaining from counsel, a detailed opinion as to why "DoD has serious doubt" that the provisions of the Defense Production Act could effectively be invoked to require contractor performance on contracts or orders containing Cost Accounting Standards.

It is my understanding, based on the July 17 letter from the Director of the Federal Preparedness Agency, General Leslie Bray, that he has the authority, under the Act, to enforce performance on defense-rated contracts and orders but that enforcement of compliance with the Cost Accounting Standards is the responsibility of the procuring agency. This, I take it, is merely a

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division of responsibility and a legitimate one, but it is not to be taken in any way as eroding the President's power to command full performance of all provisions of contracts related to the national defense.

One of the most fundamental functions of a government based on law is to enforce valid contracts; failure to carry out this function would seriously impair the legal underpinning of our society. I believe it is an especially serious matter when the government is unable, or gives the appearance of being unable, to enforce its own contracts. You will understand, therefore, why I view this as a matter of paramount importance. If there are deficiencies in the Defense Production Act in this regard, the Joint Committee will clearly want to consider taking remedial legislative action.

Sincerely,

William Proxmire
Vice-Chairman

Additional Questions for Assistant Secretary of Defense John Bennett

1. Who are the DoD employees engaged in conducting the CAS training course at Ft. Lee, Virginia? How many of the 2-week training courses were scheduled to be offered in FY 1975? Were all of these courses actually held? Assuming that the 150 persons which you contemplate training in FY 1976 constitute four 2-week training courses, is this an adequate number of courses, or have other considerations caused a reduction in the optimum number of courses to be offered? Are there no more than 150 DoD personnel a year whose performance could be improved by attending the 2-week CAS training program?

2. Who are the DoD employees at Ft. Lee who are conducting the cost effectiveness study? Are these the same persons who would otherwise be training DoD personnel in CAS administration? If so, do you regard the cost effectiveness study as more important than training DoD personnel in CAS matters?

3. What is the methodology of the cost effectiveness study itself? How does it intend to measure benefits derived from Standards? Doesn't the DoD's failure to date to measure the cost impact of hundreds of reported CAS violations suggest that the measurement of benefits will be difficult?

4. With respect to your statement that 275 man-years were estimated to have been devoted in FY 1975 to CAS administration, please specify the actual number of positions authorized by DoD and filled by DCAA and DCAS in FY 1974 and in FY 1975 by employees whose work has been the administration of CAS. How many of these positions are new positions and how many are partial or total reassignment of existing personnel?

5. Please identify the contractors who have told DoD that because of the requirements of P.L. 91-379, they are reluctant to make cost accounting changes voluntarily, even though the changes may be desirable improvements that are supported by the auditor and contracting officer. What have been the circumstances involved in these cases?

6. How many cost impact statements did DoD receive from contractors prior to issuance of DPC 74-5? How many after its issuance? Isn't it reasonable to assume that the time needed for preparation and review of these statements will be less and less as both contractors and Government gain experience with them? In light of the CASB comments on materiality, why do you believe that formal review and documentation are required in cases of insignificant cost impact?

7. Specifically, what does the DoD do to convince an unwilling contractor to accept the CAS clause? Have you asked contractors to demonstrate the changes which would be required in their current accounting systems in order to comply? Have you sought the help of the CASB Staff experts in any such meetings?

8. Please identify those companies which you state often resist CAS and refuse to change their accounting systems to conform to Standards. Has DoD worked with these companies to determine how much, if any change in their accounting systems would be necessary to conform to CAS?

9. Has any company which has indicated an intention of withdrawing from defense business actually done so? Which are the companies? Have any of them been sole source suppliers to the DoD? If so, what steps has DoD taken as a consequence? Which companies have indicated an intention of withdrawing?

10. With respect to the DoD recommendation of March 12, 1975, to the CASB that it establish a 5 percent of sales exemption from CAS, what data did DoD have and what were its recommendations to the CASB on the following issues inherent in that recommendation: (a) the definition of "sales"; (b) whether "sales" should be determined every year, or as an average of several years; (c) the definition of "profit center," especially in view of the possibility of corporate reorganizations; (d) the proper treatment of any problems of the profit center whose sales or Government business, or both, fluctuate annually in such a way as to result in coverage in certain years and non-coverage in other years; (e) how soon after expiration of the measurement period a firm would be requred to accept the CAS clause, or would be exempt from its inclusion; (f) how DoD would ascertain the accuracy of any calimed exemptions; and (g) the degree, if any, of anticipated resistence by firms to Government audit of the claimed total sales of their profit centers?

11. Does your proposal for an outright exemption for all foreign prime and subcontract awards indicate DoD dissatisfaction with the proposals now being finalized by the CASB with the U.K. Government, looking to disclusure and consistent use of existing cost accounting practices by U.K. firms? Would not the proposals for U.K. firms provide for many of the benefits to the DoD of P.L. 91-379, which outright exemption would wholly forego?

12. Was the recent establishment of the central group to respond to CAS problems made by the DoD at its own initiative, or was the central group established as a result of recommendations in the draft GAO report, urging to DoD the need for such a group?

13. You say (p. 2) that DoD has been diligent in its efforts to get CAS off to a good start. Nevertheless, in an attachment to a 1974 memorandum to the Deputy Secretary of Defense, signed by one of your predecessors, Mr. A.I.Mendolia, serving as one of a high-level DoD committee looking into restoration of faith in contracting with DoD, the Cost Accounting Standards Act is identified as one of a number of laws whose requirements are redundant, difficult or burdensome to administer,out of proportion to accrued benefits, or contain overly restrictive dollar thresholds. How do you reconcile your statement with Mr. Mendolia's 1974 memorandum?

14. Can you determine and provide for the record information as to whether United States Steel at any time terminated, suspended, curtailed, interrupted, withheld,reduced, or slowed shipments of HY-80 steel, air flasks or toroid rings to the Electric Boat Division of General Dynamics under any of the five contracts or orders that were the subject of your waiver request of July 1975, as was suggesed in that request?

15. Does the Electric Boat Co. now have signed, valid contracts with the U.S. Steel Corporation for the provision of this steel plate, air flasks and toroid rings? Do each of these contracts contain the Cost Accounting Standards? If not, why?

16. Can the government enforce the inclusion of Cost Accounting Standards on subcontracts or orders between a prime contractor and a subcontractor? If so, how? Can the government direct a prime contractor to withhold payment of funds to a subcontractor who does not comply with government-required contract provisions?

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

INSTALLATIONS AND LOGISTICS

2 OCT 1975

Honorable William Proxmire
Vice Chairman, Joint Committee
on Defense Production
Congress of the United States
Washington, D. C. 20510

Dear Senator Proxmire:

This is in response to your letter of September 5, 1975. You referred to my testimony before the Joint Committee on Defense Production and asked for an explanation of my statement to the effect that we doubted that we could immediately invoke the provisions of the Defense Production Act to require a contractor to comply with the cost accounting standards.

The Department of Defense does not have the authority under the Defense Production Act to force a supplier to enter into a contract with us. We must rely upon the prospective contractor's willingness to contract. Where a supplier refuses to enter into a contract, we must look to the Commerce Department's Bureau of Domestic Commerce to require the supplier to accept the contract under Title I of the Defense Production Act.

General Bray in his letter to you dated July 17, 1975 stated that the Federal Preparedness Agency had authority to require acceptance of a contract under Title I but that it "... did not view refusal to comply with cost accounting standards as a refusal to produce under a rated order." That issue, he said, would have to be resolved between the supplier, the procuring agency and the CAS Board.

We agree that once we have a contract, the procuring agency is responsible for enforcing compliance with its terms, including the requirements of the Cost Accounting Standards clause. However, we must look to the Department of Commerce to require the supplier to accept the contract which contains the Cost Accounting Standards clause. Absent a contract there is no means whereby the procuring agency can enforce compliance with Cost Accounting Standards.

General Bray also states that in his opinion section 18(a) of DPS Regulation 1 was not intended to provide a legal basis for a contractor to refuse a priority order because the contract contains required provisions of law which the contractor dislikes. We believe that the wording of that regulation is at odds with its intent as stated by General Bray. It appears, therefore, if the regulation is to be applied in cases where a contractor refuses to accept the CAS clauses, a change in the regulation will be required.

I would like to take this opportunity to enlist your assistance in having the Cost Accounting Standards Board favorably consider a de minimus rule for applying the requirements of PL 91-379. As I stated in my testimony on August 20, 1975, it is unrealistic to expect a contractor to agree to follow Cost Accounting Standards regulations which will increase his administrative cost, require changes in his accounting practices, and eliminate his flexibility to make accounting system changes to accommodate a very minor part of his total sales. We believe that a major portion of our implementation problems are concerned with this class of contractor because they simply cannot understand our lack of concern with materiality. Such a de minimus rule should free up resources that can best be used to assure compliance where the impact is significant. In a similar vein we will shortly request exemptions for firm fixed price contracts awarded on the basis of negotiated price competition and for contracts placed with foreign firms. We believe you could greatly aid us with improved implementation if you support these actions.

The answers to your other questions are set forth on the attachment to this letter.

Sincerely,

John J. Bennett

JOHN J. BENNETT
Acting Assistant Secretary of Defense
(Installations and Logistics)

Enclosures
a/s

1. Who are the DoD employees engaged in conducting the CAS training course at Ft. Lee, Virginia? How many of the 2-week training courses were scheduled to be offered in FY 1975? Were all of these courses actually held? Assuming that the 150 persons which you contemplate training in FY 1976 constitute four 2-week training courses, is this an adequate number of courses, or have other considerations caused a reduction in the optimum number of courses to be offered? Are there no more than 150 DoD personnel a year whose performance could be improved by attending the 2-week CAS training program?

The individuals now conducting the CAS course at the Army Logistics Management Center, Ft. Lee, Virginia are as follows: Mr. Edward J. Barrett, Mr. John H. Green, Jr., Mr. David C. Relly, and Mr. Steven C. Van Voorhees.

In FY 1975 there were ten courses originally scheduled. Six courses, with a total of 206 students, were conducted, and four were cancelled. With respect to FY 1976, nine classes are presently scheduled and it is expected that 324 students will be trained. In consideration of the number of personnel that can reasonably be released from regular duties at one time for CAS training and the facilities and training personnel available we believe the rate of training is appropriate.

2. Who are the DoD employees at Ft. Lee who are conducting the cost effectiveness study? Are these the same persons who would otherwise be training DoD personnel in CAS administration? If so, do you regard the cost effectiveness study as more important than training DoD personnel in CAS matters?

We have not yet identified the specific individuals who will conduct the cost effectiveness study. We do not plan to use the same people who are conducting the training course. The training people will contribute by providing advice and other consulting services, but classes will be conducted on a full schedule.

3. What is the methodology of the cost effectiveness study itself? How does it intend to measure benefits derived from Standards? Doesn't the DoD's failure to date to measure the cost impact of hundreds of reported CAS violations suggest that the measurement of benefits will be difficult?

The exact methodology and plans for this study are still under development. However, there are many areas where, we believe, quantitative measurements can be made. In some areas only qualitative measurements can be made. For example, resources used to administer CAS, and costs recovered as a result of CAS can be documented, but the value of improved visibility of a contractor's accounting system, as a result of the CAS required disclosure statement, can only be expressed in qualitative terms.

4. With respect to your statement that 275 man years were estimated to have been devoted in FY 1975 to CAS administration, please specify the actual number of positions authorized by DoD and filled by DCAA and DCAS in FY 1974 and in FY 1975 by employees whose work has been the administration of CAS. How many of these positions are new positions and how many are partial or total reassignment of existing personnel?

We have discussed this question with the Committee staff to obtain clarification of the data desired. As a result, we understand you desire to know how many new spaces were authorized due to Cost Accounting Standards, and how many man hours were employed on administration of Cost Accounting Standards. Exhibit A, attached, shows the new spaces authorized. Exhibit B shows the man years estimated to have been used.

In the statement we indicated "more than 275 man years have been devoted to the administration of CAS." This did not include the Headquarters man years of DCAA, time spent by personnel of OSD, and recognizes that the man years reported are in most cases a best estimate.

EXHIBIT A

NEW MANPOWER SPACES AUTHORIZED DUE TO
COST ACCOUNTING STANDARDS

	DCAA		DCAS	
	FY 1974	FY 1975	FY 1974	FY 1975
Carryover from prior year	0	36	63	129
Increase (decrease) for year	36*	(11)**	66***	45
Total	36	25	129	174

* Includes 69 originally approved less 33 reduction due to Congressional Budget cut.

** Includes restoration of the 33 reduction from FY 1974 less a reduction of 44 due to OSD "10-20-30 reduction" program.

*** Spaces not released to field organizations until March 1974.

EXHIBIT B

ESTIMATED MANPOWER USED BY DOD IN ADMINISTRATION
OF COST ACCOUNTING STANDARDS
(MAN YEARS)

	ARMY	NAVY	AF	DSA	DCAS	DCAA	TOTAL
FY 74							
Buying Offices	2.6	6.0	3.7				12.3
Administration Offices	.9	4.5	19.7		86.4		111.5
Headquarters	.4	1.0	1.7	.1	2.0	6.0	11.2
Audit	—	—	—	—	—	125.0	125.0
	3.9	11.5	25.1	.1	88.4	131.0	260.0
FY 75							
Buying Offices	3.3	5.5	3.7				12.5
Administration Offices	1.5	5.5	22.0		120.6		149.6
Headquarters	.4	1.0	2.0	.1	2.0	6.0	11.5
Audit	—	—	—	—	—	112.0	112.0
	5.2	12.0	27.7	.1	122.6	118.0	285.6

5. Please identify the contractors who have told DoD that because of the requirements of P. L. 91-379, they are reluctant to make cost accounting changes voluntarily, even though the changes may be desirable improvements that are supported by the auditor and contracting officer. What have been the circumstances involved in these cases?

Contractors have not gone on record that they would not make voluntary accounting changes, but they have informally indicated on numerous occasions that the requirements to submit voluminous contract cost impact data, the extensive negotiation requirements, the administrative effort required to amend contracts and the CAS regulation preventing recovery of increased costs not fully offset by decreases in other CAS contracts make voluntary changes undesirable. It would be unrealistic to believe that contractors will not seriously weigh the impact of all these factors before making any voluntary changes.

We also believe that one aspect of this problem is the fact that contractors are reluctant to make voluntary changes until they are aware of all of the Standards that will be issued. Otherwise, a possible voluntary change will be made which within a short period might be at odds with a new standard which would force another change. All changes whether voluntary or mandatory require the expenditure of resources. We find most contractors unwilling to make voluntary changes when there is a potential that such an effort may be overcome by later standards.

6. How many cost impact statements did DoD receive from contractors prior to issuance of DPC 74-5? How many after its issuance? Isn't it reasonable to assume that the time needed for preparation and review of these statements will be less and less as both contractors and Government gain experience with them? In light of the CASB comments on materiality, why do you believe that formal review and documentation are required in cases of insignificant cost impact?

The DoD Cost Accounting Standards reporting system, which was developed in coordination with the CAS Board staff, provides for reporting the number of noncompliances with disclosed practices and Standards issued and the number disposed of during the year. It does not provide for reporting the number of cost impact statements received. An impact statement may cover more than one noncompliance as well as accounting changes and therefore cannot be related to the number of noncompliances. Prior to DPC 74-5 which was issued March 4, 1975 there was no contract clause which contractually required a contractor to submit a cost impact statement when an accounting change was to be made. DPC 74-5 included a new contract clause on "Administration of Cost Accounting Standards" to be incorporated in new contracts issued which requires a contractor to submit a description of the accounting change as well as a cost impact proposal.

Although the DoD reporting system for CAS does not cover the number of cost impact statements received, through inquiries we have found that approximately 245 were received from July 1, 1974 to March 31, 1975 and approximately 71 were received from April 1, 1975 to June 30,

1975. We are not able to determine how many of these were received as a direct result of the new clause contained in DPC 74-5. A contractor must review and document the effect of an accounting change before there can be a determination of whether the impact is significant or insignificant. The depth and extent of the Government's review of a contractor's cost impact statement will be influenced by the cost impact on Government contracts. We agree that where it is evident that the cost impact is insignificant only a limited review would normally be made. It is reasonable to assume that the time expended in the preparation and review of cost impact statements will decline as more experience is gained. However, the extent of the decline may not be sufficient to have a material impact on workload.

7. Specifically, what does the DoD do to convince an unwilling contractor to accept the CAS clause? Have you asked contractors to demonstrate the changes which would be required in their current accounting systems in order to comply? Have you sought the help of the CASB staff experts in any such meetings?

8. Please identify those companies which you state often resist CAS and refuse to change their accounting systems to conform to Standards. Has DoD worked with these companies to determine how much, if any change in their accounting systems would be necessary to conform to CAS?

9. Has any company which has indicated an intention of withdrawing from defense business actually done so? Which are the companies? Have any of them been sole source suppliers to the DoD? If so, what steps has DoD taken as a consequence? Which companies have indicated an intention of withdrawing?

You have asked a series of 3 interrelated question identified as number 7, 8 and 9, which we feel must be answered together. Basically they inquire as to what does DoD do to convince a resisting contractor to accept the CAS clause including seeking help of the CASB experts (7), which companies resist CAS (8), and what companies have indicated an intention to withdraw from Government Business due to CAS (9).

There are a few contractors whom we have not been successful in convencing to accept the clause, and who indicate that they will withdraw from government business. Other contractors have indicated reluctance to accept the clause and are still exploring the problem. In other cases of resistance, we have, through consulation, fear of bad publicity, or persuation, been successful in obtaining acceptance of the clause.

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When the problem cannot be solved at the local level, and we have no other course of action readily apparent to obtain the supplies, the case is elevated for consideration by higher authority. We have a few such cases now, and examples of these are set forth below.

As to requesting CASB assistance, we have on some occasions discussed cases with the CASB staff. However, we have not maintained any records to reveal the extent of their involvement or frequency. We feel that they could supply you with that data.

The following cases do not include those where a waiver was sought and obtained. Most cases where a waiver was obtained are foreign contractors. Also, some contractors such as Alcoa, have appealed directly to the CASB and we have no way of having a complete list of these.

The cases presently before us and recently handled are as follows:

a. E. I. duPont de Nemours and Company, Inc.
Freon Products Division
Wilmington, Delaware 19898

Dupont has refused to accept the CAS clause as they feel it is not applicable to their sales. It is DSA's position that if adequate price competition exists and this is relied on to determine that the price

is fair and reasonable, the award is made on the basis of competition regardless of the possible existence of a catalog or market price. Dupont's position is that the interpretation leads to an unwarranted elimination of the catalog or market price exemption. Of course, the regulation provides that if a catalog or market price is established, the CAS clause is not required. This problem will be further reviewed to determine the proper interpretation of the regulation.

b. Caterpillar Tractor Company
Industrial Division
Defense Products Department
Peoria, Illinois 61602

(1) There was a requirement for five road graders which had not been produced before, but which Caterpillar stated were to be commercial items.

(2) The items were to be sold to Venezuela under the Foreign Military Sales program and Caterpillar was considered sole source.

(3) In the opinion of DoD, there was no catalog or market price. However, the company refused to comply with CAS requirements.

(4) A request for waiver of Cost Accounting Standards was denied by the CAS Board.

(5) Purchase request was cancelled as nonprocurable. In addition Caterpillar is a proposed subcontractor with Hughes Aircraft Company under the U.S. Roland Missile System. They have indicated they will not accept a government contract with the CAS clause.

The Army is exploring the matter with the Hughes Company seeking an alternate for the procurement.

c. Ingersoll Rand Corporation
Cameron Pump Division
Phillipsburg, New Jersey 08865

It is corporate policy to reject any CAS clause. Currently Ingersoll Rand is trying to show that catalog or market prices exist for several items procured by DSA. Further discussions will be held with the company. In addition, Ingersoll Rand has stated to the Navy its intent to withdraw from Defense Business but the company has yet to actually effect such a withdrawal. It has a sole source position for certain products and the Navy is currently examining other sources that could be qualified for these products.

d. Gulf Oil Trading Company
Gulf Building
Pittsburgh, Pennsylvania 15230

As in the case of duPont cited above, Gulf is questioning the need of the CAS clause in price competitive procurements if catalog or market prices also exist. Gulf has formally protested this interpretation to the GAO.

e. H. F. Oliufulagid
Sudurlandsbraut 18
Reykjavik, Iceland

This company is foreign owned and contracts are awarded to them for overseas performance. They refused to accept the CAS clause. Contracts were then awarded overseas for overseas performance and were not subject to the CAS clause.

f. One contractor, the Ladish Company, has informally indicated that it may withdraw a proposal for a subcontract with Martin Marietta under the Titan III program. Ladish Company is a sole source subcontractor for rocket motor forgings used on both Titan III and Minuteman III programs. Since this was an informal indication to the prime contractor the Air Force has taken no action as yet.

g. A recent problem developed with purchase of fuel for foreign use from a foreign Shell affiliate. A New York sales company, Asiatic Shell, normally negotiates such contracts, and subcontracts to the foreign affiliate. The foreign Shell subcontractor refused to discuss or accept CAS and we requested a waiver for this subcontractor. The waiver was denied, leaving us with no practical alternative source of supply. The procurement was only completed after Asiatic Shell withdrew and permitted direct contracting with the foreign subsidiary. Since this transaction was completed entirely overseas it was outside the purview of the CAS law and CAS is not applicable.

10. With respect to the DoD recommendation of March 12, 1975 to the CASB that it establish a 5 percent of sales exemption from CAS, what data did DoD have and what were its recommendations to the CASB on the following issues inherent in that recommendation: (a) the definition of "sales"; (b) whether "sales" should be determined every year, or as an average of several years; (c) the definition of "profit center", especially in view of the possibility of corporate reorganizations; (d) the proper treatment of any problems of the profit center whose sales or Government business, or both, fluctuate annually in such a way as to result in coverage in certain years and non-coverage in other years; (e) how soon after expiration of the measurement period a firm would be required to accept the CAS clause, or would be exempt from its inclusion; (f) how DoD would ascertain the accuracy of any claimed exemptions; and (g) the degree, if any, of anticipated resistence by firms to Government audit of the claimed total sales of their profit centers?

The questions presented are similar to those posed by the CAS Board when they discussed the 5% sales extensions some months ago. As we advised the CAS representatives, we do not believe the problems inherent in the questions present serious obstacles, and they are surely no more difficult than those faced in the preparation of the standards themselves. In most cases there are several acceptable solutions. Among suggestions we made were the following: (a) Definition of sales. We would suggest that any definition which is in accordance with accepted accounting practices and IRS regulations would probably be acceptable if it is consistently followed. (b) Compute sales each year or average several years' sales. Either procedure would probably be satisfactory. Other alternatives are also available such as requiring CAS in all contracts for two years following any year in which CAS sales exceeded 5%. (c) Profit centers vs reorganizations. It has been suggested that contractors would reorganize and create new profit centers to avoid over running the 5% threshold at any one profit center. We believe reorganization for such a purpose would

seldom occur. It seems doubtful that contractors would disrupt their operations by moving operations from one location to another from one set of managers to another just to avoid CAS. If CAS is that onerous it seems more probable they would simply refuse CAS business. Moreover, this approach would seldom be possible for defense contractors who have relatively major defense business. (d) Contractors with fluctuating CAS sales. We see no problems here. The contracts written in years when the contractor is subject to CAS would include the CAS clause. Contracts written in other years would not. Any resultant mixture of CAS and non-CAS contracts is no different than the current situation where every contractor with CAS contracts also has non-CAS government contracts. (e) Timing for accepting CAS clause after measurement. Assuming it would take 90 days to make the measurement after the close of a contractor's fiscal year, contracts written for the following 12 months, two years or other selected time period would be subject to CAS. If the beginning and end of the CAS covered period did not coincide with the contractor's fiscal year, such difference in timing would make no difference as to the applicability of the clause. (f) & (g) Accuracy of claim exemptions. Contractors would be required to submit detailed data to support the exemption claim. This would be similar to present procedures for claiming CWAS exemptions. Such claims would be subject to DCAA audit and if audit is refused by the contractor, exemptions would not be granted. Based on our experience in reviewing commercial exemptions under PL 87-653 and qualification applications under Contractor Weighted Average Share in

Cost Risk, both of which require similar types of audit verification, we do not anticipate significant resistance to government audit of profit centers.

11. Does your proposal for an outright exemption for all foreign prime and subcontract awards indicate DoD dissatisfaction with the proposals now being finalized by the CASB with the U.K. Government, looking to disclosure and consistent use of existing cost accounting practices by U.K. firms? Would not the proposals for U.K. firms provide for many of the benefits to the DoD of PL 91-379, which outright exemption would wholly forego?

Our thinking at this time is not to request the CAS Board to provide an outright exemption for foreign contractor unless there is no other way to obtain the supplies involved. In some cases, foreign contractors may agree to accept some part of the CAS regulations. In these instances, complete exemption is not necessary. In other cases, a complete exemption is the only alternative. We have no objection to having the CASB develop such an arrangement. However, pending the time such agreements are worked out, a general exemption would be appropriate so that orderly procurement action can proceed. It must be recognized that the Department of Defense has no means of forcing foreign contractors to perform or in many cases to assuring that they adhere to the side agreements made.

12. Was the recent establishment of the central group to respond to CAS problems made by the DoD at its own initiative, or was the central group established as a result of recommendations in the draft GAO report, urging to DoD the need for such a group?

Establishment of a top level policy group to provide special guidance and assistance to field personnel has been discussed several times in the past months. The final determination to establish such an organization was strongly influenced by the recommendations of the GAO.

13. You say (p. 2) that DoD has been diligent in its efforts to get CAS off to a good start. Nevertheless, in an attachment to a 1974 memorandum to the Deputy Secretary of Defense, signed by one of your predecessors, Mr. A. I. Mendolia, serving as one of a high-level DoD committee looking into restoration of faith in contracting with DoD, the Cost Accounting Standards Act is identified as one of a number of laws whose requirements are redundant, difficult or burdensome to administer, out of proportion to accrued benefits, or contain overly restrictive dollar thresholds. How do you reconcile your statement with Mr. Mendolia's 1974 memorandum?

We do not believe that there is any conflict between our statement before the hearings and the position of Mr. A. I. Mendolia in his 1974 memorandum. We believe it is obvious from all the evidence that the CASB rules, regulations and standards have imposed a new era of administration problems for DoD. DoD did react to the requirements of the law.

14. Can you determine and provide for the record information as to whether United States Steel at any time terminated, suspended, curtailed, interrupted, withheld, reduced, or slowed shipments of HY-80 steel, air flasks or toroid rings to the Electric Boat Division of General Dynamics under any of the five contracts or orders that were the subject of your waiver request of July 1975, as was suggested in that request?

The Navy has provided the status of these orders as shown on the attached pages. The Navy also advises that the delays on these orders to date have not affected the scheduled deliveries of ships under Navy shipbuilding contracts.

P.O. No. K 7039-801

This order calls for twenty-three items of HY-80 steel plate for the TRIDENT lead submarine. U.S. Steel promised shipment (on its own acknowledgement form) beginning in September 1974 and completing in December 1974. None of the items was shipped in September 1974; and eight entire items and three partial items, shipped after December 1974, were late from one to seven months. In addition, one entire item and part of another item, both delivered in July 1975, were found unacceptable and rejected and have not yet been redelivered.

P.O. No. K 5065-700

This order calls for eleven shipsets consisting of two items each of HY-80 steel plate for the SSN 688 Class submarine.

a. As to Item 1, U.S. Steel promised shipment (on its own acknowledgement form) for only eight shipsets under a schedule calling for two shipsets each in December 1974, and August, September, and November 1975. No shipping dates have yet been furnished for the remaining three shipsets. Only one of the two shipsets of Item 1 (consisting of two plates), scheduled to be shipped in December 1974, was shipped on time. One of the two plates for the second shipset was not delivered until June 1975; and the second plate has not yet been delivered. U.S. Steel advised on July 29, 1975 that a small section of the second plate had been ground down below the minimum acceptable thickness in order to remove an imperfection. On September 2, 1975, Electric Boat advised that it was willing to undertake weld repair of this plate after delivery and charge the cost to U.S. Steel. Presumably, delivery of this plate will now be made. Shipments of two shipsets, scheduled for August 1975, have not yet been received.

b. As to Item 2, U.S. Steel promised shipment (on its own acknowledgement form) for only ten of the eleven required shipsets under a schedule calling for two shipsets each, in November and December 1974, and in August, September, and October 1975. Shipment of two of the four shipsets scheduled for 1974 were delayed; one of these was not received until August 1975; and only a part of the other has now been received, and this not until September 1975. None of the remaining shipsets have yet been received.

P.O. No. K 5056-700

This order calls for eleven shipsets consisting of two items each of toroid rings for the SSN 688 Class submarine.

a. As to Item 1, U.S. Steel promised shipment (on its own acknowledgement form) on only five of the shipsets under a schedule calling for one each in March, August, October, and December 1975, and February 1976. To date only the March shipment has been received. The August shipment has now been promised for November 1975. The remaining three shipsets for which a shipping date has been promised presumably will be late. No promised delivery date has yet been received for the remaining six shipsets.

b. As to Item 2, U.S. Steel promised shipment (on its own acknowledgement form) for only five shipsets calling for one each in March, August, September, and December 1975. Only the March shipment has been received. The August shipment has been promised for September and the September shipment for October 1975. No promised shipment dates have yet been received for the remaining six shipsets.

P.O. No. K 5077-701 issued October 1974
P.O. No. K 5235-102 issued December 1974

These purchase orders, each calling for eleven shipsets of air flasks for the SSN 688 Class submarine, have not yet been formally acknowledged by U.S. Steel. Accordingly, they do not now contain promised deliveries. However, U.S. Steel has orally advised that shipment of one shipset will be made in February 1976.

15. Does the Electric Boat Co. now have signed, valid contracts with the U.S. Steel Corporation for the provision of this steel plate, air flasks and toroid rings? Do each of these contracts contain the Cost Accounting Standards? If not, why?

DoD has previously provided for the record a memorandum from Captain W. J. Ryan for the Deputy Assistant Secretary of Defense (Procurement) dated 29 August 1975 advising that the signed purchase orders, in their final form, were not yet available, they will be provided. OSD will forward the orders to the committee as soon as received from the Navy.

16. Can the government enforce the inclusion of Cost Accounting Standards on subcontracts or orders between a prime contractor and a subcontractor? If so, how? Can the government direct a prime contractor to withhold payment of funds to a subcontractor who does not comply with government-required contract provisions?

The clause prescribed the CAS Board for securing the prime contractor's agreement to comply with cost accounting standards provides that the contractor shall include the same clause in its subcontracts. However, when speaking to enforcement of CAS requirements in subcontract (as in prime contract) situations it is necessary to distinguish the prospective subcontractor who will not agree to accept a subcontract with a CAS clause from the subcontractor who will not honor the terms of the contract he has agreed to.

Where a prospective subcontractor refuses to accept a subcontract with the CAS clause the prime contractor may (a) find another source, if possible, (b) attempt to persuade the subcontractor to voluntarily comply or (c) attempt through the Government to force compliance through the Defense Production Act. As with prime contracts there is some question whether the Federal Preparedness Agency and the Department of Commerce will use the Defense Production Act for this type of enforcement.

If the subcontractor has accepted a subcontract including the clause whereby it agrees to comply with cost accounting standards but the subcontractor fails to honor that agreement, the clause itself permits certain adjustments in the price of the subcontract. A clause prescribed for inclusion in the

prime contract provides procedures for passing any adjustment in the subcontract on to the Government.

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EXHIBIT 21

Congress of the United States
JOINT COMMITTEE ON DEFENSE PRODUCTION
(CREATED PURSUANT TO PUBLIC LAW 774, 81ST CONGRESS)
WASHINGTON, D.C. 20510

September 8, 1975

The Honorable James R. Schlesinger
Secretary of Defense
Room 3E880, Pentagon
Washington, D. C. 20301

Dear Mr. Secretary:

On August 20-21, 1975, I chaired hearings of the Joint Committee on Defense Production in connection with a recent request submitted by the Department of Defense on behalf of the United States Steel Corporation for waiver of Cost Accounting Standards. One item that disturbed me a great deal was the casual attitude the Defense Department took with regard to enforcing Cost Accounting Standards. In the case of U.S. Steel, for instance, the Defense Department forwarded a waiver request to the Cost Accounting Standards Board. Mr. David M. Roderick, President of U.S. Steel, testified that no one in the Department of Defense personally contacted him or any other senior official of U.S. Steel at any time regarding U.S. Steel's position on the issue of Cost Accounting Standards. Yet, two weeks after the request for waiver was submitted, the Cost Accounting Standards Board got U.S. Steel to reverse its prior position and agree that they could and would comply with Cost Accounting Standards.

Over the years, the Defense Department also has taken a similar attitude toward obtaining defense contractors' compliance with the Truth-in-Negotiations Act. For example, the record shows that the Department of Defense twice declined to assist the Navy in obtaining U.S. Steel complaince with the Truth-in-Negotiations Act on the basis that U.S. Steel's refusal

to comply was a "Navy Problem." Many other firms have not been required to comply with the Act.

I now understand that the Armed Services Procurement Regulations(ASPR) Committee is considering a proposal to further downgrade the Truth-in-Negotiations Act by delegating authority to waive its requirements, in the case of subcontracts, from the Assistant Secretary level to procurement activities.

In my opinion, any downgrading of the waiver authority would be a mistake. If the Defense Department is serious about enforcing the Truth-in-Negotiations Act it must be willing to throw the weight of the military services behind the effort. Individual procuring activities can rarely muster sufficient leverage to obtain compliance from large firms. Waivers should be sought only in exceptional circumstances. Therefore, consideration of such requests would not place too great an administrative burden on senior government officials. In addition, centralized handling of waiver requests should promote consistency and equity in their disposition.

It is the responsibility of senior government officials to enforce legislation enacted by Congress. If the authority to waive requirements of the law is abused, it may be necessary to rescind such waiver authority altogether or to restrict by law those who may exercise it.

I would appreciate your personal assurance that the Department of Defense will actively enforce the Truth-in-Negotiations Act and that waiver authority under the Act will not be delegated below the Assistant Secretary level.

Sincerely,

William Proxmire
Vice-Chairman

cc: Chairman Wright Patman

THE DEPUTY SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301

OCT 7 1975

Honorable William Proxmire
Vice Chairman, Joint Committee
on Defense Production
Congress of the United States
Washington, D. C. 20510

Dear Senator Proxmire:

This is in reply to your letter of September 8, 1975 to Secretary Schlesinger concerning the hearings which you chaired on August 20-21, 1975. Secretary Schlesinger has asked that I reply for him. Your letter includes several matters which I will address separately herein.

I can assure you that the Department of Defense does not take a casual attitude toward enforcing cost accounting standards or any other legislation. We believe our record is good in assuring compliance with all laws enacted. Many of the laws that have been passed to aid in better contracting followed the development of similar regulations or policies by the DoD. The "Truth In Negotiation Act", PL 87-653 is a prime example. Also, we contributed heavily to the feasibility study leading to the passage of PL 91-379, and endorsed its passage.

The DoD has devoted substantial resources to the implementation of these standards, including the interpretation and promulgation of guidance on the standards, training of personnel and daily activities of our buying, contract administration, and audit personnel. The enforcement of the standards has been timely and thorough. We will continue to seek ways to improve DoD procedures covering the standards, including the processing of waivers.

On 12 March 1975, we wrote the CAS Board to request their consideration of establishing an exemption of any contractor's profit center with less than 5 per cent defense work. In our view, it is unrealistic to expect a contractor to agree to follow CAS regulations which will

increase his administrative cost, require changes in his accounting practices, and eliminate his flexibility to make accounting system changes to accommodate a very minor part of his total sales. His reaction is likely to be an uneconomic decision to segregate defense work or discontinue taking defense contracts. The CAS Board is currently reviewing this proposal.

In addition to the 5 percent exemption, we are also preparing to request the Board to exempt foreign prime and subcontractors and ~~the~~ to exempt firm fixed-price contracts awarded on the basis of negotiated price competition. The reasons for making such a request were clearly set forth in Dr. Bennett's testimony on August 20, 1975. I would like to solicit your support in aiding us to achieve these revisions which we believe will make it easier to implement this law without destroying the intent.

With regard to the Truth In Negotiations Act, DoD's implementation thereof has been effective over many years. Our records indicate that in the instances referred to in your letter involving U.S. Steel, our action was to require the Navy to exhaust all possibilities available to it to resolve the situation before referring the matter to OSD. This is a proper management action.

We currently have under review the implementation of the Truth In Negotiations Act. Currently, authority to waive the requirements of the Act exists at the level of the Assistant Secretary (Installations and Logistics) in the Military Departments, with authority delegated to Heads of Procuring Activities overseas to execute waivers where a foreign supplier is involved. We intend to make a further delegation in cases of subcontracts of $1,000,000 or less to the Head of a Procuring Agency (HPA) who we believe can best assess the situation without undue administrative processing. We do not believe this delegation in any way downgrades the DoD implementation of the Act. Our experience shows that the cases involved are for the most part technical compliance matters, not reluctance on the part of the subcontractor to comply. The price to be paid by DoD is seldom if ever at issue. As an example, we may decide to make a final follow-on buy of a few additional systems. The pricing of some subcontracts may be only the extrapolation of prices from earlier buys provided there is no break in production. Although we would obtain certified cost or pricing data from the prime, it simply may be too costly to require every subcontractor to produce similar data. We believe that more economical compliance with PL 87-653 can be achieved by this policy change.

I do appreciate your deep concern with both the Truth in Negotiation Act and the Cost Accounting Standards Act in view of your personal involvement in previous hearings. I can assure you that DoD has and will continue to administer these laws to the best of our ability. We do not believe that either law can be effectively administered without an understanding and appreciation of special circumstances which can arise in the otherwise normal procurement process. We believe that the intent of both laws is sound and we are dedicated to carrying out the intent of each.

Sincerely,

H. P. Clements Jr.

[EXHIBIT 22]

SEPTEMBER 8, 1975.

Hon. ELMER STAATS,
Chairman, Cost Accounting Standards Board, Washington, D.C.

DEAR MR. STAATS: I have recently received from the National Security Industrial Association a statement of their position with regard to Cost Accounting Standards. The Association submitted its views for inclusion in the record of the Joint Committee's hearings on August 20th and 21st.

I am forwarding the N.S.I.A.'s position statement as a matter which the Board may wish to take into account in its deliberations. If you or the Board should care to comment for the record on the proposals or representations made by the National Security Industrial Association, the hearing record will be held open pending your reply.

With kindest regards and best wishes, I am

Sincerely,

WRIGHT PATMAN,
Chairman.

NATIONAL SECURITY INDUSTRIAL ASSOCIATION
National Headquarters
Union Trust Building, Suite 700
15th and H Streets, N.W.
Washington, D.C. 20005
Telephone: (202) 393-3620

4 September 1975

The Honorable
Wright Patman
Chairman, Joint Committee on Defense Production
U. S. Senate
Senate Office Building, Annex 3, Room A-419
Washington, D. C. 20510

Dear Mr. Chairman:

The National Security Industrial Association appreciates the opportunity to submit for the record its views on certain issues raised in the Committee's hearings held on 20 August 1975 on compliance with cost accounting standards.

NSIA is a non-profit association of approximately two hundred fifty American industrial and research companies of various types and sizes, from large to small, representing all segments of an industry which provides products and services to the United States Government. The Association's essential purpose is to foster an effective working relationship and good two-way communications between the Government and the industry in the interest of the national security.

We feel that the basic question involved here is not whether any company whose services or products are essential to the defense effort can thereby obtain exemption from fair conditions of doing business with the Government, but rather whether Government regulation of private industry doing business with the Government shall be allowed to become so onerous that it is no longer economic for a company to compete for Government business under the terms and conditions related to that business.

The question of the reasonableness and fairness of regulations applicable to Government business is especially pertinent when such regulations are applicable to only a minor portion of the company operations, but require changes in basic company systems for the management of the preponderance of its business otherwise not subject to such regulations. A prime example of this is the case where, by acceptance of one contract subject to the Cost Accounting Standards (negotiated contract in excess of $500,000) a contractor operation doing hundreds of millions of dollars of commercial business would find itself obliged either to:

a. Revise its entire cost accounting system to comply with the regulations and cost accounting standards applicable to the one relatively insignificant contract, or

b. Maintain an extra separate cost accounting system relative to the one contract.

Where neither of the above choices are economically justified as they relate to a decision whether to compete for the contract, a prudent management will under such circumstances reach a decision not to compete for nor accept such a contract.

The particular situation examined in the hearings is illustrative of many similar instances where American industry is faced with the question, not whether it will wilfully and unjustifiably withhold its services and products from the Government, but whether, because of the special burden of unique and onerous regulations imposed on such business, it is economically feasible to offer its products or services under those conditions.

The members of NSIA are deeply concerned with the trend toward over-regulation of defense contractors which is:

a. Imposing unnecessary and unique costs on industry, and thereby driving up the costs of defense and lowering the quantity and quality of defense products and services obtainable for each of the taxpayers dollars.

b. Reducing the willingness of many (in many cases, the more competent and conscientiously managed) companies to enter the Government business market, and thereby eliminating much effective competition, to the Government's disadvantage.

c. Eroding away the industrial base of companies skilled in producing for the unique requirements of the Government, especially in defense, so that in times of a national emergency the nation's ability to respond to the emergency would be seriously impaired.

We note from the testimony of the DoD witness, Dr. John J. Bennett, that DoD field activity for the administration of CAS in Fiscal year 1975 was estimated at 275 man-years, a very substantial amount when converted to dollars along with attendant support costs. This does not include the administrative costs of other Government agencies involved in CAS. We estimate that industry administrative costs are at least three or four times more. We see this excessive burden increasing rather than decreasing and we see no corresponding benefit other than certain intangibles and unquantifiable improvements mentioned in the CASB Annual Report to Congress.

In order to lessen this undue burden, we agree in general with the simplifying and clarifying measures suggested by Dr. Bennett on pages 11 and 12 of his statement, but in a broader vein we suggest again that the Committee weigh carefully the eyes-growing accumulation of special costs related to doing business with the Government as a result of over-regulation in many areas. It is the total of all such burdens, now augmented by the addition of excessive implementation costs for Cost Accounting Standards, that is leading competent

and desirable contractors to wonder whether doing business with the Government is a rational choice in the interest of their stockholders or for their survival in the free economy in which lies their primary responsibility.

Sincerely,

J. M. LYLE
President

JML/B/ac

COST ACCOUNTING STANDARDS BOARD
441 G STREET, N.W.
WASHINGTON, D.C. 20548

ARTHUR SCHOENHAUT
Executive Secretary

September 18, 1975

The Honorable Wright Patman
Chairman
Joint Committee on Defense Production
Congress of the United States

Dear Mr. Chairman:

Thank you for the invitation in your letter of September 8, 1975, to comment on the statement of position submitted to you by the National Security Industrial Association, for inclusion in the record of the Joint Committee on Defense Production's hearings on August 20 and 21.

The Statement submitted by the Executive Secretary of the Cost Accounting Standards Board and his testimony at the hearing on August 20 address many of the matters raised in the NSIA statement.

The Board is concerned that its requirements not add unduly to what Admiral Lyle refers to as the special burden of unique and onerous regulations imposed on business. In the case of U. S. Steel Corporation and the Aluminum Company of America, two companies mentioned at the August 20 hearing, meetings between CASB staff members and responsible officials of those companies have resulted in agreement by those officials with our conclusion that neither company would be required to make any substantial adjustment in its existing cost accounting practices in order to comply with the requirements of the CASB. It has, indeed, been our experience that when responsible company officials address themselves to specific CASB requirements, they very often conclude that little or no change in their existing cost accounting practices would be required to achieve compliance with those regulations.

The Board is also concerned that the amount of man-hours required for administration of CAS matters in the Government and by defense contractors not be disproportionate to the benefits derived from use of Standards. Government estimates of man-years have not, to date, been verified. The Board heard testimony at its Evaluation Conference in Chicago on June 11, 1975, from industry spokesmen that administrative costs in industry would

be, as Admiral Lyle states, three or four times as much as Government administrative costs. No support for those estimates was provided to the Board at the Evaluation Conference and while we have tried, we have not been successful since that time in obtaining data to support the estimates.

Sincerely yours,

Robert B. Abbott

Chairman

EXHIBIT 23

SUMMARY
OF

(Summary provided by DoD, March 23,1976)

ENCLOSURE (1) TO OASN(I&L) PROCUREMENT MEMORANDUM OF 14 JANUARY 1976 TO DASD(PROCUREMENT), OASD(I&L)

Purchase Order					Acknowledgement of Acceptance		
Number	Date	From	Signed By	To	CAS	Cost Data	Other Pertinent Data
K5056-700	7/5/74	General Dynamics Corp. Electric Boat Div. Groton, Conn.	D. H. Painter Dir. of Procurement	U. S. Steel Corp. Eastern Steel Div. Boston District Boston, Mass.	Yes	Yes	
K5065-700	7/8/74	"	"	"	"	"	
K5235-102	12/20/74	"	"	"	"	"	
K5077-701	10/9/74	"	M. C. Curtis for J. D. Pierce General Mgr.	"	"	"	
K7253-501	7/24/75	"	J. D. Pierce General Mgr.	"	"	"	
A7013-803	8/8/75	"	D. H. Painter Dir. of Procurement	"	"	"	
J7248-801	2/12/74	"	J. D. Pierce General Mgr.	"	"	"	
K7039-801	5/13/74	"	J. W. Long Mgr of Procurement Special Programs & Facilities	"	"	"	
K7176-801	9/11/74	"	D. H. Painter Dir. of Procurement	"	"	"	
K7267-801	11/27/74	"	M. C. Curtis for J. D. Pierce General Mgr.	"	"	"	
J7073-801	5/10/75	"	W. E. Nagle Mgr. of Subcontracts & Special Programs	"	"	"	
K7119-801	8/14/74	"	D. Peitzke Mgr. of Procurement New Construction	"	No	No	Catalogue Price. DD Form 633-7 Submittal by U.S. Steel to Support Catalogue Price is Currently Being Reviewed by the Government