THE UNITED STATES RENEGOTIATION BOARD

by

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CHAPTER I

INTRODUCTION

Subject and Scope

The verb "renegotiate" as defined by Webster's New Collegiate Dictionary means "to readjust (a government war contract or subcontract or the price stipulated) by negotiation with a price-adjustment board charged (under section 403 of Public Law 528, 77th Congress) with elimination of any excessive profits made out of the war."[1]

The process of renegotiation and the federal agency known as the Renegotiation Board are the subjects of this paper. Renegotiation is one of the most controversial aspects of defense procurement today, and the opposing factions are well defined--on the proponent side is the administration and the Renegotiation Board, and on the opponent side are the various lobbies of the defense manufacturers.

Renegotiation is important because present-day military procurement involves an outlay of some $40 billion annually, and the efficient use of these funds is, or should be, of prime interest to the Department of Defense, Congress, and the taxpayer. Renegotiation, as carried out by the Renegotiation Board (hereinafter referred to as the Board), consists of an after-the-fact examination of a contractor's profits and

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[1] Webster's New Collegiate Dictionary (Sixth Edition, 1959), p. 717.

performance on all his renegotiable business for a fiscal year. Thus, the examination contributes in some measure to the efficient use of funds by providing for the recapturing of any excessive profits from the contractor. The Board does not directly audit the procurement policies of the various components of the Department of Defense as does the General Accounting Office, but rather has the specific function to review a contractor's entire defense business for a particular fiscal year, regardless of whether or not the profits on the individual contracts were excessive. In other words, the Board is interested in the aggregate, not the details.

The author's primary purpose in writing this paper was to show that the complex, secretive, and controversial process of renegotiation does have an impact on national defense procurement, and that it is important to all concerned with renegotiation that they study the process and try to determine if and how it should be changed.

To carry out the stated purpose, the paper encompasses the following areas: (1) the background and evolution of renegotiation, covering the profit controls of World War I through to the Renegotiation Act of 1951, (2) the World War II experience with renegotiation as a fledgling process, (3) the operations and procedures of the Renegotiation Board, (4) the major problems connected with renegotiation, and (5) the principle arguments for and against renegotiation, including a discussion of the 1962 Truth in Negotiations Act.

It was not the author's intent to exhaustively study or discuss any one particular aspect or problem of renegotiation;

rather, the intent was to present a survey or overview of the entire sphere of renegotiation and to let the reader form his own judgment as to the usefulness or validity of renegotiation.

Methodology and Organization

The bulk of the paper was written through the use of source materials from various libraries in the Washington, D.C. area. The Renegotiation Board library and the Library of Congress were most helpful in this respect. Most of the literature on renegotiation has been published in the form of Congressional hearings and reports and as articles in the various business and professional periodicals. There are, however, some books that have dealt with the subject. The most recent and one of the best is Procurement and Profit Renegotiation, edited by J. Fred Weston. The book was not written from one man's point of view, but rather was a collection of various articles and papers on the general subject of renegotiation. Because of this diversity of opinion, the book was very helpful in the preparation of the latter chapters of this paper.

Other excellent source material came from the various Congressional hearings that have been held on renegotiation and from the study done by the Joint Committee on Internal Revenue Taxation. Since most of the hearings contain basically the same points of view, the principle ones used were those held by the House Committee on Ways and Means in 1959 and in 1968.

Material for the chapters concerning the actual procedures of renegotiation came mostly from publications of the Board, including the Annual Reports and the Renegotiation

Regulations.

The paper is divided into six chapters of which this introduction is the first. Chapter II presents a broad review of the history of profit limitation and renegotiation from 1915 to 1951. Chapter III examines the process of renegotiation and the operations and organization of the Renegotiation Board. Chapter IV identifies some of the difficulties associated with renegotiation, and Chapter V outlines some of the changes that have been proposed to the process. Chapter VI closes the paper with a brief exposition of the conclusions of the author.

CHAPTER II

HISTORICAL ASPECTS OF RENEGOTIATION

Pre-1942

World War I

The entry of the United States into World War I occasioned the greatest industrial build-up in our history. It was a build-up that was partially prepared for in advance in that for the first year of the war, the country was a large-scale supplier of raw materials and industrial products to the allies, and as such some industries had adapted for and were geared to war production. Also, the country, because of its neutral position, was able to observe the burdens that war production placed on the industrial sectors of other countries. However, even with this advance knowledge and preparation, the first four months of the American war effort have been characterized as generally chaotic, principally due to the fact that there was no organized governmental agency to assume control over industries.

This control was seen as necessary, according to Adams, because

> Comparatively few individuals at the time had any clear insight into the need for centralized, coordinated, and maximized industrial output, the efficient and prompt diversion of this output to military purposes (in the broadest sense), the restriction of unnecessary production and consumption, the checking of the price inflation

which had become acute by 1916, and--above all--the means by which all this was to be achieved.[1]

Seven months prior to the United States' entrance into the hostilities there was established a Council of National Defense which was to be responsible for the "coordination of industries and resources for the national security and welfare" and the "creation of relations which will render possible in time of need the immediate concentration and utilization of the resources of the nation."[2] An Advisory Commission was also appointed, each member of which was to be an expert in some field of industry, thereby paving the way for the establishment of committees of industry with which the government could negotiate purchase prices of various raw materials.

Neither the Council of National Defense nor the various agencies spawned by it were able to exert a broad enough control over industry to insure its "orderly, prompt and efficient mobilization." To try to alleviate this problem, there was created on July 28, 1917, by the Council, with President Wilson's approval, a War Industries Board, the basic function of which was to "act as a clearing house for the war-industry needs of the Federal Government . . . and consider price factors."[3]

But neither was the War Industries Board able to solve

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[1]George P. Adams, Jr., Wartime Price Control (Washington, D.C.: American Council on Public Affairs, 1942), p. 4.

[2]Ibid., pp. 6-7.

[3]Ibid., p. 8.

the ever-increasing problem of coordination of industrial expansion, and so on March 4, 1918, the powers of the Board were expanded and a Chairman, Bernard M. Baruch, was appointed by the President. To broaden the function of price control, Baruch immediately set up a Price Fixing Committee, the main purpose of which was to "advise upon prices of basic materials."[1] This Committee, although created by the War Industries Board, reported directly to the President and was therefore regarded as independent of the Board.

The Price Fixing Committee was not given blanket authority by Congress to issue price regulations pertaining to broad classes of products, but instead had to go about it in a piecemeal, commodity-by-commodity fashion. Baruch, in his book, American Industry in the War, said that most of the price fixing was "done by negotiation and agreement between the Government and the trades."[2] Thus appeared the principle of negotiation of contracts, a principle which was to come into prominence in World War II and which was to lead to the principle of renegotiation.

One of the primary reasons that price control was needed during the war was the inflationary temperament of the economy. There exists in the literature of World War I several accounts of the nature of this inflation; it is not within the

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[1] Ibid., pp. 10-11.

[2] Bernard M. Baruch, American Industry in the War (New York: Prentice-Hall, Inc., 1941), p. 75.

scope of this paper to explore it.[1] Generally it may be said, however, that during the period 1913-1918, prices on most commodities rose to a level higher than in any other period in our history, and that these prices were passed on not only to the government, but also to the individual consumer, thereby raising his cost of living. With the price rise, moreover, also came a wage increase, which added another element to the inflationary spiral in which the economy was engaged.

The purpose of government control of prices during the war was not primarily to insure low prices, but rather "to bring as nearly as possible to reality that ideal condition in which the country as one man would be bending its energies to the satisfaction of the all-impelling war needs."[2] The officials in Washington knew that prices could not arbitrarily be set at too low a figure because the stimulation of production in many essential industries would then be lacking. It was also fairly well recognized that even with granting the businessmen the highest qualities of patriotism, the "vision of fair reward" was the most stimulating factor to wartime production. On the other hand, profits earned by manufacturers were not looked on with great favor by many people in the country, especially those who had relatives in the armed forces. The Committee's difficult task, then, was to strike an

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[1]See, for example, Adams, Wartime Price Control, pp. 14-23; Baruch, American Industry, pp. 1-107; and Julius Hirsch, Price Control in the War Economy (New York: Harper & Brothers, 1943), pp. 14-23.

[2]Baruch, American Industry, pp. 83-84.

equitable balance between no profits and excess profits. As stated by Baruch,

> The aim of the Committee was to establish the figures where no honest man should have sound grounds for complaint that he did not receive "just compensation," measured in terms of cost production for the commodity which he furnished; and yet so that, as far as was humanly possible, men should not use their country's distress for their own inordinate aggrandizement.[1]

Effectiveness of Price Controls

Adams points out that price fixing has several defects when used for the purpose of controlling profits. For one thing, a price set high enough to provide an incentive to produce and a profit for marginal or high-cost manufacturers will result in very large profits for efficient, low-cost producers. Also, price fixing commodity by commodity was inefficient in that no definite unified policy was applied to all industries or even to all segments of a particular industry. Table 1 illustrates this last point.

TABLE 1

PERCENTAGE OF PROFIT OR LOSS ON ALL BUILDING MATERIALS SOLD TO THE GOVERNMENT AT FIXED PRICES[a]

Common Brick	3.76%
Crushed Stone	11.70
Grits	-10.80 (Loss)
Gypsum Plaster Board	7.00
Gypsum Wall Board	1.65
Hollow Building Tile	6.30
Portland Cement	7.50
Sand and Gravel	10.03
Sand-lime brick	9.60
Mill work	4.02

[a]Adams, Wartime Price Control, pp. 102-03.

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[1]Ibid., p. 84.

In addition, price fixing alone does not insure against the realization of excessive profits because many manufacturers who turned to the production of war materials increased their level of production many times without additional investment of their own capital; thus they increased the return on their investment to very high levels.

Regardless of the many faults of price fixing, it is generally accepted that wartime price controls were effective in some ways. For instance, the fixing of wholesale prices and profit margins for fuels and foods halted, or at least decreased, the exploitation of consumers and prevented the market prices from being magnified by the fear of shortages. And in all probability, many prices in other industries would have risen further than they did if it were not for government price control.[1]

Nevertheless, according to Adams, "There can be no question of the profitability of the war years, both before and after American participation."[2] For example, the average rate of return for 120 steel companies ranged from a 1915 rate of 7.4 per cent to a high of 28.7 per cent in 1917, with a tapering off to 20 per cent in 1918. In 1913, 21 copper companies had an average return of 11.7 per cent, and in 1918 the average return was 24.4 per cent.[3]

Any conclusions made about price fixing during World

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[1] Ibid., pp. 103-04.

[2] Ibid., p. 104.

[3] Ibid., p. 105.

War I should take into account that (1) it was a pioneer effort begun in an atmosphere of skepticism; (2) businessmen, the press, and many economists were hostile to the whole idea of government price fixing; and (3) the price fixing authorities themselves were largely drawn from the business world and thus had to placate their own consciences as well as critical elements around them.[1]

Post World War I

After the war, frequent cries of "war profiteer" were heard in and out of Congress. Congressional committees, public officials, and groups of private citizens castigated those "who had profited from the slaughter."[2] The Federal Trade Commission, in one of the earliest reports drafted on the subject of profiteering, stated that

> The Commission has reason to know that profiteering exists. Much of it is due to advantages taken of the necessities of the times as evidenced in the war pressure for heavy production. Some of it is attributable to inordinate greed and barefaced fraud.[3]

One widespread claim given much publicity was that 23,000 millionaires were created as a result of World War I.[4] This unsubstantiated allegation served to add fuel to the

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[1] Ibid., p. 110.

[2] Richards C. Osborne, The Renegotiation of War Profits (Urbana, Ill.: University of Illinois, 1948), p. 9.

[3] U.S., Congress, House, Committee on Military Affairs, Hearings on H.R. 3 and H.R. 5293, Taking the Profits Out of War, before the Committee on Military Affairs, 74th Cong., 1st sess., 1935, p. 605. These hearings contain a reprint of the original report of the FTC, Senate Document 248, 65th Cong., 2d sess., 1918.

[4] Ibid., pp. 618-19.

outcry against profiteers, and, coupled with the not insignificant feeling that the citizens at home should be paid the same as the boys fighting in the trenches, caused demands for reform in legislation and for a complete survey of all the war policies.[1]

One of the most active groups in keeping the subject of war profits before Congress was the American Legion. This organization was the prime mover behind several bills introduced in Congress for the purpose of taking the profit out of and equalizing the burdens of war. The Legion strongly advocated the creation of the War Policies Commission, which had as its purpose to

> study and consider amending the Constitution of the United States to provide that private property may be taken for public use during war . . . [and] study methods of equalizing the burdens and removing the profits of war, together with a study of the policies to be pursued in the event of war.[2]

The Commission undertook this formidable task and in 1932 issued a report containing several recommendations, one of which was an amendment to the Constitution defining the power of Congress to prevent profiteering and stabilize prices in time of war. Another recommendation was for a 95 per cent tax to be imposed on individual and corporation incomes in excess of the previous three-year average.[3]

Although none of the recommendations of the Commission was adopted, numerous investigations concerning excessive

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[1] Ibid., p. 619.

[2] Ibid., pp. 3-37.

[3] Ibid., pp. 3-4.

profits continued to be made in the 1930's. The public reaction towards profiteering had by this time subsided greatly, but Congressional committees pursued the inquiry at length. Both political parties agreed that contractors had received excessive profits during the war, but agreement was nowhere near as unanimous as to how to prevent such occurences in the future. One suggestion made was to tax away 100 per cent of excess profits and another was to nationalize industry during wartime. The majority of bills introduced during the period had as premises the following: (1) profiteering was an important cause of war, and (2) laws limiting personal gain could make the country immune from such a conflict.[1]

Regardless of the validity, or lack thereof, of these premises, the only legislation to come from all the investigations prior to 1934 was that outlawing (in most cases) cost-plus-a-percentage-of-costs contracts which had been very prevalent during the war.[2]

In 1934, the Vinson-Trammell Act was passed.[3] This Act was the direct forerunner of renegotiation and provided for a profit limitation of 10 per cent on contracts for naval ship construction and (by amendment in 1939) for a limitation of 12 per cent on naval and army aircraft construction.

The Merchant Marine Act of 1936 was a further step in controlling peacetime profits, and it contained similar profit

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[1] Osborne, War Profits, p. 9. [2] Ibid.

[3] Vinson-Trammell Act, Statutes at Large, XLVIII, sec. 3, 95 (1934).

provisions applicable to merchant ships contracted for by the Maritime Commission. In addition, this Act elaborated on the costs which were allowable under these contracts. One limitation included to pacify some of the critics that had complained of the enormous salaries that contractors had been charging to the government was that no more than $25,000 in annual salary for an individual could be counted as a cost in fulfilling a ship contract.[1]

The Treasury Department was given the task of determining and collecting any profits in excess of the amounts specified in either of the Acts. The problem was complicated by the fact that most of the information regarding costs, revenues, exemptions, etc. was obtained from reports submitted by the contractors, and this information was, for the most part, unverified by government auditors due to lack of time, money, and expertise.[2]

Efforts to control profits during peacetime were not very successful as most of the contracts were of a cost-plus type, thereby creating for the contractors an incentive not to increase efficiency but to increase costs so that a greater dollar profit might be realized. A Senate Special Investigating Committee noted the following reaction to the passage of the Vinson-Trammell Act by shipbuilders and contractors:

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[1] Merchant Marine Act, Statutes at Large, XLIX, sec. 505(b), 858 (1936).

[2] U.S., Congress, Senate, Special Committee on Investigation of the Munitions Industry, Preliminary Report on Naval Shipbuilding, 74th Cong., 1st sess., 1935, p. 324.

> Very shortly after the bill was passed the shipbuilders and the large suppliers and Navy contractors, and later the comptrollers of these various groups, got together in long session to determine how the interpretations of the bill could be arranged to suit their interest. The main question was how to increase costs.[1]

In June, 1940, Congress further reduced the profit margin allowed by the Vinson-Trammell Act by passing the Speed-up Act.[2] The 8 per cent limitation imposed by this Act reflected the belief of Congress that even at 8 per cent, the contractors were allowed sufficient opportunity for profits because of the increased procurement of ships and aircraft that was underway. The Act was also an implicit attempt to cut down the amount of dollar profits realized through inflation of costs.

The contractors, however, were not agreeable to this new reduction. Foreign markets provided more opportunity for profit, and the United States' defense build-up began to suffer as more and more contractors refused to enter into government contracts. This increasing reluctance finally prompted Congress in September, 1940, to rescind the reductions imposed.

1942-1951

With the attack on Pearl Harbor on December 7, 1941 and the subsequent entry of the United States into World War II, war production in all phases increased tremendously. But, irrespective of the warnings of Bernard Baruch that the country

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[1] Ibid., p. 323.

[2] Statutes at Large, LIV, 676 (1940), P.L. 781, 76th Cong., 3d sess.

should be ready with specific procedures "for industrial mobilization, elimination of profiteering, and equalization of the burdens of war,"[1] there was no plan for an effective system for limiting war profits. There were statutes concerned with price and wage controls, rationing, excess-profits taxes, and systems of priorities, but these were seen as not really effective against profiteering of the magnitude experienced in World War I.

Most government contracts since World War I had been let by competitive bidding, but World War II brought forth a change in emphasis toward contracting by negotiation. The procurement and manufacture of urgent war materials with the greatest speed was the primary purpose of the negotiation type of contract. Two classes of items were procured in this way: (1) common, everyday items which could be priced through catalogs, and (2) special materials such as tanks, battleships, and the like. It was the second class that caused the greatest problems. To cope with the increased demand for all types of certain war products, new factories had to be built and old ones had to be converted (often with a substantial proportion of government funds). Once capable facilities were established, the problems of pricing became paramount. Since many of the products desired had never been made or even designed before, the prices arrived at between the government and the contractors were frequently only estimates, and poor ones at that. Thus, it became evident that somehow the prices

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[1] Baruch, American Industry, pp. 377-477.

on contracts would have to be redetermined or renegotiated in order to protect everyone's interest.[1] A partial solution to this problem took the form of a system of voluntary renegotiation instituted by the War and Navy Departments and the Maritime Commission. Contractors were asked to retroactively redetermine their contract prices taking into account previous production experience and present conditions.[2]

But voluntary renegotiation was not enough. A famous case in which public attention was again focused on profiteering and which led to specific Congressional action on excess profits was that of United States v. Bethelehem Steel Company.[3] In World War I, the government had entered into a contract with Bethlehem allowing the company incentive profits of 50 per cent of the difference between actual and estimated costs of the ships built by Bethlehem. Profits of 22 per cent came to be realized by the company, and the United States brought suit to recover a portion of these profits. The Supreme Court upheld Bethlehem because there had been no provision in the contract for recoupment of excess profits. More importantly, however, the Court clearly put the burden of legislating against war profits on the shoulders of Congress by the following statement from the opinion by Justice Black:

The problem of war profits is not new. In this

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[1]Madeline E. Franks, "Renegotiation of War Contracts" (unpublished thesis, Portia Law School, 1944), pp. 13-15.

[2]E. E. Hagedorn, "A Survey of Renegotiation" (unpublished thesis, The George Washington University, 1960), p. 21.

[3]U.S. v. Bethlehem Steel Company, 315 U.S. 289 (1942).

> country, every war we have engaged in has provided opportunities for profiteering and they have been too often scandalously seized. See Hearings before the House Committee on Military Affairs on H.R. 3 and H.R. 5293, 74th Cong., 1st Sess., 590-598. To meet this recurrent evil, Congress has at times taken various measures. It has authorized price-fixing. It has placed a fixed limit on profits, or has recaptured high profits through taxation. It has expressly reserved for the Government the right to cancel contracts after they have been made. Pursuant to Congressional authority, the Government has requisitioned existing production facilities or itself built and operated new ones to provide needed war materials. It may be that one or some or all of these measures should be utilized more comprehensively, or that still other measures must be devised. But if the Executive is in need of additional laws by which to protect the nation against war profiteering, the Constitution has given to Congress, not to this Court, the power to make them.[1]

A further impetus to the realization of a renegotiation law was the revelation by a Congressional Naval Affairs Committee of the enormous profits received by the Jack and Heintz Company, manufacturers of army airplane equipment. The company had received considerable publicity for its novel way of treating its employees or "associates." Free lunches, vacations, uniforms, use of company resorts, and very high pay were some of the benefits dispensed by Jack and Heintz.[2] However, the government did not receive any "benefits" in the form of contract price reductions, and, as a matter of fact, appeared to be paying for a large part of the "benefits" received by the "associates." After the Committee made public its findings, Jack and Heintz voluntarily reduced prices by $10 million on $50 million worth of government contracts still outstanding. Other companies quickly followed suit to escape

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[1] Ibid. [2] Franks, "War Contracts," p. 22.

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[1] Ibid. [2] Franks, "War Contracts," p. 22.

the onus of unfavorable publicity.[1]

This belated voluntary effort to reduce prices was not enough to halt the renegotiation movement in Congress, and on April 28, 1942, the Sixth Supplemental Defense Appropriations Act was passed. Section 403 of this Act, more popularly known as the Renegotiation Act of 1942, provided that the Secretaries of the War Department, Navy and Treasury Departments, the Maritime Commission, and various other defense agencies were required

> to insert in any contract for an amount in excess of $100,000.00 . . .
> (1) a provision for the renegotiation of the contract price at a period or periods when, in the judgment of the Secretary, the profits can be determined with reasonable certainty;
> (2) a provision for the retention by the United States from amounts otherwise due the contractor, or for the repayment by him to the United States, if paid to him, of any excessive profits not eliminated through reductions in the contract price, or otherwise, as the Secretary may direct.[2]

This first Renegotiation Act was designed to serve two principal functions: (1) adjusting contract prices to those which would have been agreed upon if the factors known at the present time had been known when the contract was let, and (2) recapturing excess profits which had been realized, or were

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[1] "Profits--End of Uncertainty," Time, October 5, 1942, pp. 82-83.

[2] Sixth Supplemental Defense Appropriations Act, Statutes at Large, LVI, sec. 403(b), 247 (1942).

likely to be realized by contractors.[1] To assist the government in carrying out these functions, the law provided that contractors were required to submit certain financial information to the various Secretaries and to open their books to government auditors for the purpose of ascertaining the methods of accounting used in determining costs and revenues.[2]

There was considerable controversy in the months following passage of the Renegotiation Act. The business community was unsure of what the law was supposed to do and how it was going to do it. And since the Secretaries of the Departments had delegated the administration of renegotiation to their respective War Contract Price Adjustment Boards, the Boards naturally desired and needed clear meanings as to the intent of Congress in passing the bill. In addition, various definitions and administrative procedures outlined in the law required further clarification in order to become moderately workable. One of these hazy definitions, called a "masterpiece of ambiguity," was that of "excessive profits." The original wording follows: "The term 'excessive profits' means any amount of a contract or subcontract price which is found as a result

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[1] "Rules for Renegotiation," Business Week, August 22, 1942, pp. 14-15. See also U.S., Congress, Senate, Committee on Finance, Renegotiation of Contracts, Hearings before the Committee on Finance, Senate, on Section 403 of Public Law Numbered 528, An Act Making Additional Appropriations for the National Defense for the Fiscal Year ending June 30, 1942, and for other purposes, 77th Cong., 2d sess., September 22, 23, 1942, p. 17.

[2] Sixth Supplemental Defense Act, sec. 403(e).

of renegotiation to represent excessive profits."[1]

On the basis of this section, many businessmen rather cynically adopted the view that Congress recognized that what business makes on its war contracts depended more and more on government price adjustment boards.[2]

Osborne succinctly sums up the position of businessmen on renegotiation as stated in the press and before Congressional hearings:

> Many business groups, large and small, vociferously declared "This can't be done to us." They lambasted the Act as wholly un-American, unconstitutional, unnecessary, ill-advised, or detrimental to the war effort and the economic stability of the country. These and other businessmen prefaced their remarks, however, with a statement that excessive profits should not be made from the war. As a matter of strategy, their specific proposals dealt primarily with revisions that would emasculate the Act; they did not advocate its outright repeal. Each industrial group considered itself to be a special case and suggested amendments to the law which would reduce drastically or eliminate recoveries from their own profits.[3]

Several basic objections to the law were voiced by both contractors and government officials charged with administering renegotiation. First, postwar reconversion reserves were not allowed. Industry wanted to make some allowance for the anticipated costs of retooling machinery and converting plants to peacetime production at the end of the war. Second, renegotiation was thought to be a one-sided

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[1] Ibid., sec. 403(a)(4).

[2] "Great Game of War Contracts," Time, November 16, 1942, p. 94.

[3] Osborne, War Profits, p. 19.

affair, with all the cards being held by the government. This was especially true with respect to the proceedings before the various price adjustment boards; there was no right of appeal to the courts for the contractor. Third, most businessmen and some government officials wanted standard commercial articles exempt from renegotiation, especially those that already came under Office of Price Administration price ceilings. Fourth, the Act was thought to be discriminatory in that it applied only to defense producers and not to farmers and other wage earners. Fifth, there was a constant threat of uncertainty in that there was no specific formula for determining exactly what constituted "excessive profits."[1]

Many of these and other related objections were valid and were not to be dealt with to everyone's satisfaction for the duration of the war. However, as a result of pressure from business, administrative officials, Congressional investigating committees, and the general public, Congress enacted the Renegotiation Act of 1943 on February 25, 1944. Several changes from the previous Renegotiation Act were made

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[1]For a discussion of these points and variations thereto, see the following: Osborne, Ibid., pp. 20-21; "Change of Rules," Business Week, October 10, 1942, pp. 27, 30; "Rules for Renegotiation," Business Week, August 22, 1942, pp. 14-15; "Profits in a Vise," Business Week, August 15, 1942, p. 14; "New Deal on War Contracts," Business Week, August 15, 1942, p. 100; "Renegotiation Keeps Industry Stumbling in Fiscal Blackout," Newsweek, October 19, 1942, pp. 54, 57; National Industrial Conference Board, Inc., Renegotiation of Government Contracts (Washington, D.C.: National Industrial Conference Board, Inc., 1942), p. 7; "How We Take the Profiteer Out of War," Saturday Evening Post, March 27, 1943, p. 100; "Industry's Renegotiation Case," Business Week, July 3, 1943, p. 108; "How's Your Renegotiation?" Fortune, February, 1944, pp. 140-41; "Preparing Postwar Jobs in the Dark," Nation's Business, November, 1943, pp. 28-30.

in this new law. One was the establishment of a War Contracts Price Adjustment Board, in which was vested the responsibility for formulation and promulgation of uniform policies and practices for renegotiation. Another was the provision of appeal to the Tax Court of the United States by contractors who felt aggrieved at a unilateral determination by one of the agency price adjustment boards.

One of the most important changes was that of a redefinition of excessive profits. The previous definition was expanded to include seven statutory factors which had to be taken into account by any board which was in the process of determining excessive profits. These factors were: (1) efficiency of contractor, (2) reasonableness of costs and profits, (3) amounts and sources of public and private capital employed, (4) extent of risk assumed, (5) nature and extent of contribution to the war effort, (6) character of business, and (7) other factors that may be published in regulations of the boards.[1]

Industry objections to the Act of 1943 did not substantially differ from those directed against the first Renegotiation Act: but by this point in time, most companies realized that renegotiation was, for all intents and purposes, a permanent part of the wartime process. There were still

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[1] Renegotiation Act of 1943, Statutes at Large, LVIII, sec. 701(b), 63 (1944). For a discussion of the statutory factors required to be taken into account and of the other changes to the Act of 1942, see the following: Osborne, War Contracts, pp. 21-22; "Renegotiation Methods Stand," Business Week, June 10, 1944, pp. 21-24.

numerous conflicts over procedural matters and over some of the basic tenets of renegotiation, but most of the parties involved preferred renegotiation over other, less desirable alternatives.[1] And the effects of renegotiation were not all bad. For instance, businessmen, by having to undergo renegotiation during the war, were to an extent protected from the stigma of profiteering after the war. Defense contracting was seen as a respectable occupation, and it was to the contractors' benefit to perform to the best of their ability so that they might remain respectable.[2]

The Renegotiation Act of 1943 expired on December 31, 1945, thus fulfilling Senator Harry S. Truman's prophecy that "the Act should be writing its own death warrant by utilization of early experience in late-war contracting."[3]

Although no renegotiation law was in effect between 1945 and 1948, the review of some 120,000 war contracts subject to renegotiation was still underway, and as of May, 1938, some 98 per cent of these contracts had been reviewed. There occurred at this time a case in the Supreme Court that threatened to overturn all the profit recoveries to date. The principal issues in Lichter v. United States were the constitutionality of the Renegotiation Acts of 1942 and 1943

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[1] "How's Your Renegotiation?" Fortune, February, 1944, p. 249.

[2] War Contracts Price Adjustment Board, Final Report (Washington, D.C.: War Contracts Price Adjustment Board, May 22, 1951), pp. 2-6.

[3] "Procedure is Attacked Anew as Confusing and Unneccessary," Newsweek, June 7, 1943, p. 73.

and whether or not the failure of the petitioner to seek a redetermination of the excess profits from the Tax Court of the United States operated as a bar to further access to the Courts.[1]

The Renegotiation Act of 1943 had authorized contractors to appeal adverse decisions to the Tax Court, which had

> . . . exclusive jurisdiction . . . to finally determine the amount, if any, of such excessive profits received . . . and such determination shall not be reviewed or redetermined by any court or agency.[2]

The Lichter Company argued that renegotiation was illegal and that there was therefore no reason to appeal to the Tax Court. The Supreme Court upheld the Circuit Court of Appeals, thereby confirming the legality of renegotiation and consequently saving the government the task of returning the $11 billion in recoveries received for the period April 28, 1942 to December 31, 1945.

In 1948, renegotiation was back again as law. Power was given to the Secretary of Defense to establish three boards to administer the Renegotiation Act of 1948. The Navy, Army, and Air Force each had a five-man board, the chairman of each collectively making up a top-level Military Renegotiation Policy and Review Board which reported directly to the Secretary of Defense. Although many of the provisions of the law were the same as those in the original Acts, a certain key

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[1] Lichter v. U.S., 68 Sup. Ct. 1294 (1948).

[2] Renegotiation Act of 1943, sec. 108.

few were different, and because of these (particularly ones relating to exemptions), the Act had limited applicability.[1]

The results of World War II renegotiation were stated by the War Contracts Price Adjustment Board in its Final Report. Gross recoveries of approximately $11 billion were made on renegotiable sales of some $223 billion. Net recoveries after credit for income taxes was approximately $4 billion, and the administrative costs incurred by renegotiation were $41 million.[2]

Monetary results were not the only accomplishment, however. The following were noted as additional beneficial effects: (1) inflation was mitigated in part by the impact of lower prices in successive procurements; (2) voluntary refunds and price reductions were made, and although not directly measurable, the Board believed the amount to be substantial; (3) existence of statutory renegotiation caused contractors to price more closely than they would otherwise have done, and as a result, procurement was put on a "relatively solid footing in the latter years of the war;" and (4) businesses in general were not subjected to the widespread antagonism and close investigation as that which followed World War I.[3]

Others held views which did not see renegotiation as beneficial and successful as the War Contracts Price Adjustment

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[1] "Two Boards to Direct Renegotiation Act," Aviation Week, August 9, 1948, pp. 11-12.

[2] War Contracts Price Adjustment Board, Final Report, p. 2.

[3] Ibid., pp. 3-5.

Board did. A Senate Special Investigating Committee found several shortcomings in the ways in which renegotiation was administered, and industry found fault not only with administration, but also with the entire principle of renegotiation.

The outbreak of the Korean War saw government procurement about to mushroom, and the Secretary of Defense requested a more powerful law than what was presently in force. At one point during public testimony, a Chamber of Commerce representative said the proposed bill (H.R. 1724) was "undemocratic and un-American."[1] This represented practically no change from the organization's World War II position when Ellsworth C. Alvord, Chairman of its Finance Committee, appeared before the House Ways and Means Committee in November, 1943, and said, "The recapture of excess profits through so-called renegotiation can't be justified and the delegation of unlimited and uncontrollable powers essential to its administration is dangerous and un-American."[2]

Public testimony notwithstanding, Public Law 82-9, the Renegotiation Act of 1951, was passed on March 23, 1951. The remainder of this paper will be devoted to a discussion of renegotiation and of the federal agency created by this Act, the Renegotiation Board.

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[1]Congressional Quarterly, Inc., Congress and the Nation (Washington, D.C.: Congressional Quarterly, Inc., 1965), p. 334.

[2]Lawrence Sullivan, "Preparing Postwar Jobs in the Dark," Nation's Business, November, 1943, p. 28.

Summary

This chapter has described the efforts of the government to control wartime profits, the coordination of industrial expansion, and the inflationary character of the economy during World War I. The setting of price levels as determined by a Price-Fixing Committee under the War Industries Board was the primary means of early control. This price control was effective in some ways and not effective in others. The main area of its ineffectiveness was in the controlling of profits.

After the war, many investigations were carried out on war policies in general, and the control of war profits in particular. These investigations and the experiences developed during the war pointed out that other measures were needed to curtail the war profiteer. There was no unanimity, however, concerning the proper ways to insure that the reaping of enormous war profits would not happen again, either in peacetime or wartime.

Peacetime profit limitation was tried with the passage of the Vinson-Trammell and Merchant Marine Acts in 1934 and 1936, respectively. Neither of these Acts were regarded as a panacea for the ills of exorbitant profits.

Soon after the commencement of World War II, renegotiation, as it is known today, was initiated with the passage of the Sixth Supplemental Defense Appropriations Act. Reaction to the law was varied and sometimes violent. But as the war continued, most saw renegotiation as a necessary complement to

the other wartime measures in force.

Renegotiation expired in 1945 but was renewed to a limited extent in 1948, thus prompting additional criticisms. At the start of the Korean War, a new federal agency, the Renegotiation Board, was created for the purpose of administering the Renegotiation Act of 1951.

CHAPTER III

THE RENEGOTIATION ACT OF 1951

Introduction

The Renegotiation Act of 1951, approved on March 23, 1951, formed the basic block upon which was to be built all subsequent renegotiation legislation and regulations. The basic principles of renegotiation as outlined in the Acts of 1942 and 1943 remained the same, but many of the detailed procedures and methods of administering renegotiation did not.

For the first time in any renegotiation act, Congress stated its policy and thereby put on notice contractors, businessmen, and skeptical government officials that renegotiation was to be an integral and important part of national defense policy. Section 101 of the Act states as follows:

> It is hereby recognized and declared that the Congress has made available for the execution of the national defense program extensive funds, by appropriation and otherwise, for the procurement of property, processes, and services, and the construction of facilities necessary for the national defense; that sound execution of the national defense program requires the elimination of excessive profits from contracts made with the United States, and from related subcontracts, in the course of said program; and that the considered policy of the Congress, in the interests of the national defense and the general welfare of the Nation, requires that such excessive profits be eliminated as provided in this title.[1]

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[1] Renegotiation Act of 1951, Statutes at Large, LXV, sec. 101, 47 (1951).

The Renegotiation Board

One of the differences between the Act of 1951 and previous renegotiation acts was the creation of an independent agency in the executive branch of the Government--the Renegotiation Board (hereinafter referred to as the Board). All the functions, powers, and duties of the War Contracts Price Adjustment Board of 1943 vintage were transferred to the new Renegotiation Board.[1] This particular provision of the law caused some confusion with relation to cases still pending in the Tax Court. The original law stated that the transfer of records was not to prejudice cases which had been brought by or against the War Contracts Board provided that the Renegotiation Board filed a motion to keep the case on the docket in its own name. Due to administrative difficulties during its early existence, the Board did not file several of the required motions, with the result that the Tax Court dismissed the applicable cases. The affected contractors did not have long to rejoice, however, as the law was amended in 1954 to provide that any case dismissed due to administraitve oversight was "hereby revived and reinstated in such court as if it had not been dismissed."[2]

The Board is composed of five members appointed by the President, by and with the advice and consent of the Senate. The men comprising the original Board were recommended to the

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[1] Ibid., sec. 201(b).

[2] Ibid., sec. 201(b) as amended by Public Law 764, 83d Congress, September 1, 1954.

President by the Secretaries of the Army, Air Force, and Navy, and Administrator of General Services. According to the Board's Chairman, Lawrence Hartwig, the recommendations are made by the above-named individuals to preserve in some way the non-partisanship of the Board. He also feels that this provision alone is sufficient to maintain this non-partisanship and that a proposed requirement in the law that not more than three of the members be of the same political party (a requirement that is found in much of the law concerning regulatory commissions) would be superfluous, but not objectionable.[1]

Related to this factor of non-partisanship is that of independence. One of the primary reasons for setting up the Board was to have an independent agency oversee the entire war profits operations. Many felt that renegotiation procedures under the Department of Defense and the War Contracts Price Adjustment Boards had, since 1948, become quite loose and ineffective. Although all the members of the first Board had had much experience in renegotiation and some had even been members of predecessor War Contracts Boards, the Board was still considered independent by virtue of the fact that it reported to Congress. The previous experience and positions of the members were considered of great value to the transition and initial organization of the Board.[2]

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[1] U.S., Congress, House, Committee on Ways and Means, Extension of Renegotiation Act, Hearings, before the Committee on Ways and Means, House of Representatives, on Extending and Amending the Renegotiation Act, 90th Cong., 2d sess., 1968, pp. 51-52.

[2] Renegotiation Act of 1951, sec. 107; and "Bill Sets up New Renegotiation Board," Aviation Week, March 19, 1951, p. 16.

The present Chairman of the Board was appointed as such in 1961, some ten years after his appointment as one of the original members. The other four members of the Board were appointed between 1961 and 1963.[1]

The Board is headquartered in Washington, D.C. and has as subsidiaries the Eastern Regional Renegotiation Board (in the same location) and the Western Regional Renegotiation Board, located in Los Angeles. The two regional boards were consolidated in 1962 from the four field boards that were originally organized under the Act of 1951.[2]

Figure 1 shows the organization and duties of the headquarters Board and the organization of the regional boards.

While the organization of the Board has remained fairly stable since its inception, the number of personnel attached to it have not. Table 2 shows the number of personnel that have been on duty with the Board on June 30 of every fiscal year since 1952.

As is readily observable, the number of personnel has fluctuated from a high of 742 in 1953 to a low of 178 in 1967. The Korean War and its aftermath contributed to the high number, and government cost-cutting and employment controls contributed to the recent lows. What the table fails to bring out is that the workload of the Board has not decreased as the total number of personnel have. Increased procurement due to

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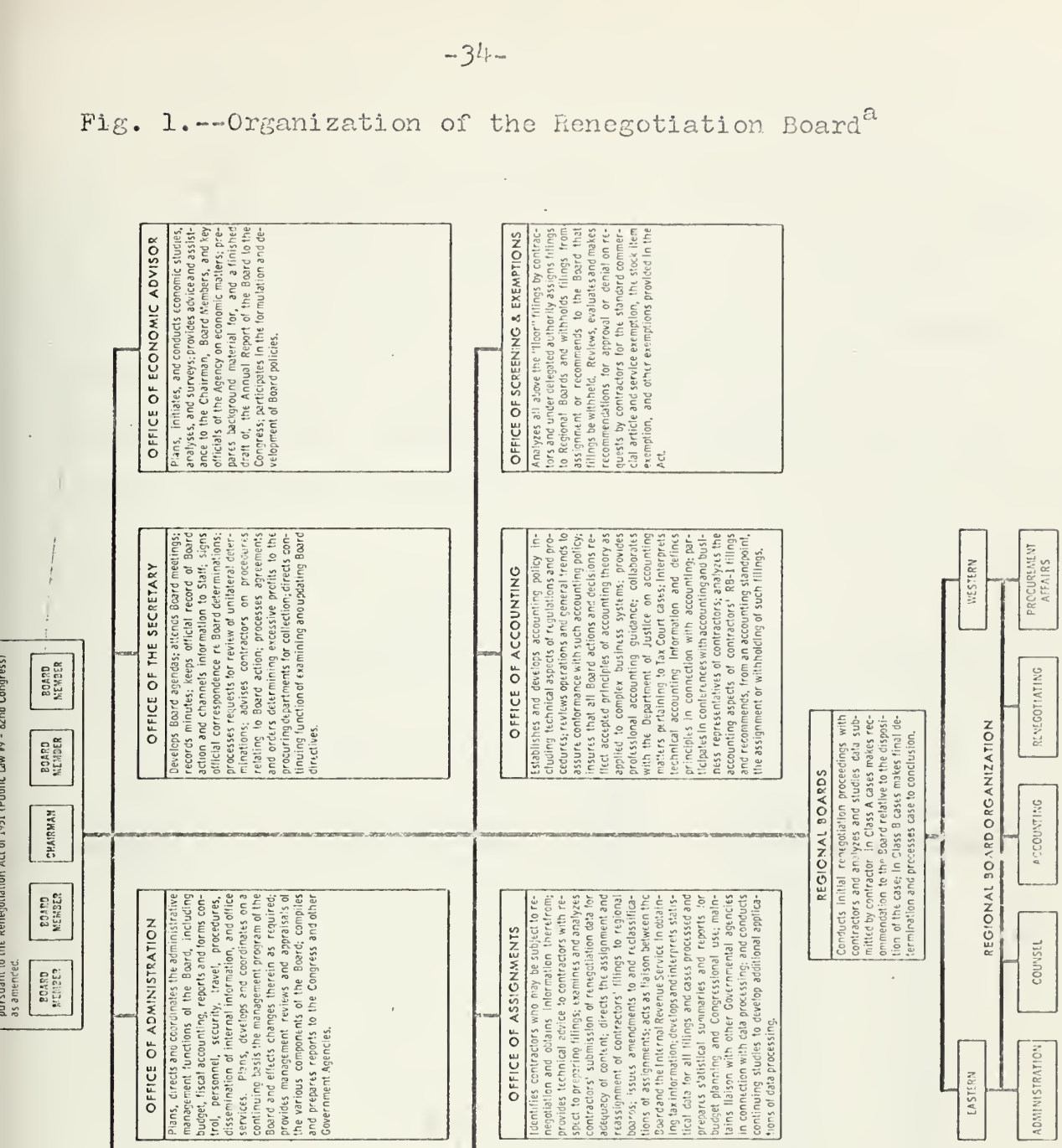
[1]U.S., Renegotiation Board, Twelfth Annual Report (Washington, D.C.: Government Printing Office, 1967), p. ii.

[2]Ibid., p. 4.

Fig. 1.--Organization of the Renegotiation Board[a]



[a]U.S., Renegotiation Board, Organization Chart (Washington, D.C.: Renegotiation Board, 1966).

Vietnam has been reflected in the amount of filings that the Board has received from contractors. The level of procurement is even greater than that of the Korean War. For example, in 1952, prime contract awards were $43.5 billion, while in 1967 they were $44.5 billion. While it is not practicable to relate personnel to dollars of obligation, at least one Representative has remarked that "the burdens per man have probably multiplied 10 times."[1]

TABLE 2

NUMBER OF PERSONNEL[a]

Fiscal Year	Head-quarters	Regional Boards	Total
1952	169	389	558
1953	178	564	742
1954	174	465	639
1955	193	347	540
1956	181	285	466
1957	155	204	359
1958	142	184	326
1959	136	165	301
1960	130	154	284
1961	123	148	271
1962	114	79	193
1963	131	92	223
1964	121	85	206
1965	108	76	184
1966	101	78	179
1967	102	76	178
1968	96	88	184

[a]U.S., Renegotiation Board, Thirteenth Annual Report (Washington, D.C.: Government Printing Office, 1968), p. 15.

[1]Testimony of Representative Charles A. Vanik, reported in House, Extension of Renegotiation Act, Hearings, p. 25.

The tables presented below detail the changes in workload experienced by the Board for the last four fiscal years.[1]

TABLE 3

FILINGS RECEIVED

Fiscal Year	Number
1965	3,673
1966	3,387
1967	3,737
1968	4,552

TABLE 4

FILINGS SCREENED

Fiscal Year	Number
1965	3,691
1966	3,372
1967	3,782
1968	4,354

TABLE 5

DISPOSITION OF FILINGS SCREENED

Fiscal Year	Number Screened	Cleared at Headquarters		Assigned	
		Number	% of Total	Number	% of Total
1965	3,691	3,336	90.4	355	9.6
1966	3,372	2,928	87.0	444	13.0
1967	3,782	3,147	83.2	635	16.8
1968	4,354	3,527	81.0	827	19.0

[1]Source of Tables 3, 4, 5, and 6: Renegotiation Board, Thirteenth Annual Report, pp. 6-7.

TABLE 6

REGIONAL BOARD WORKLOAD

Fiscal Year	Assignments Received	Assignments Completed	Ending Backlog
1965	355	457	422
1966	444	402	464
1967	635	421	678
1968	827	567	938

As the tables indicate, not only have the number of filings increased, but the percentage of cases assigned to the regional boards and the backlog at the boards have increased. Staff productivity has risen as measured by the increase in the number of cases handled by the regional boards and in the number of screenings reviewed by headquarters. But the time for processing the cases at the regional level has remained at about fifteen months, while that of the headquarters screening has declined only from forty-eight to thirty-nine days in the last two years. Thus the increased productivity has not kept pace with the rising workload.[1]

The Board is analogous to the General Accounting Office (GAO) in that both are independent agencies and report to the Congress. Unlike the GAO, however, the Board has had to justify its continued existence every one to four years, depending on the time limits of expiration as set out in the nine extensions to the original Act of 1951. For example, in 1954 the Act was extended for one year, and in 1955 it was

[1]Renegotiation Board, Twelfth Annual Report, p. 7, and Thirteenth Annual Report, p. 7.

extended for another one-year period. In 1962, it was extended for four years, and last year it was extended for three years to June 30, 1971.[1]

The Congressional hearings conducted prior to these various extensions have provided one of the few opportunities for the Board to present its case to Congress and the public. Industry also has the same opportunity to air its views at the hearings--an opportunity that is normally well taken advantage of. For example, there were submitted to the House Ways and Means Committee in March, 1968, some twenty-seven letters from interested lobbies, associations, and private citizens. Twenty-three of the letters were anti-renegotiation.[2] The four letters which were pro-renegotiation represent at least some improvement over the situation in 1966 when, in response to the Ways and Means Committee's public announcement that "it would be pleased to receive written comments from any interested individuals or organizations," only opponents of the Board replied.[3]

The Process of Renegotiation

Scope

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[1]The following are the laws that have amended and extended the Renegotiation Act of 1951: P.L. 764, 83d Cong.; P.L. 216, 84th Cong.; P.L. 870, 84th Cong.; P.L. 85-930, 85th Cong.; P.L. 86-89, 86th Cong.; P.L. 87-520, 87th Cong.; P.L. 88-339, 88th Cong.; P.L. 89-480, 89th Cong.; and P.L. 90-634, 90th Cong.

[2]House, Extension of Renegotiation Act, Hearings, pp. 201-226.

[3]Sanford Watzman, "Little Watchdog of the Dollar Warriors," The Nation, March 4, 1968, p. 298.

The Act of 1951 applies only to contracts with the following government agencies: The Departments of Defense, the Army, the Navy, and the Air Force, the Maritime Administration, The Federal Maritime Board, The General Services Administration, the National Aeronautics and Space Administration, the Atomic Energy Commission, and the Federal Aviation Administration.[1] During the Korean War, this list was considerably longer and included such agencies as the United States Coast Guard, the Defense Materials Procurement Agency, and the Federal Civil Defense Administration.[2]

The contracts with these agencies must, in the aggregate, add to more than $1 million before they are susceptible to renegotiation. In other words, a contractor does not have to undergo renegotiation for a particular fiscal year if his renegotiable sales do not amount to more than $1 million. This "floor" has not always been at the present level; it started in 1951 at $250,000, was increased to $500,000 in 1953, and was established at the present level in 1956.[3] Renegotiation is not conducted on individual contracts, but only on the totals of such contracts. The Board's Thirteenth Annual Report states the difference between renegotiation in total and on a contract-by-contract basis:

Under the statute, renegotiation is conducted not

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[1]Renegotiation Board, Twelfth Annual Report, p. 2.

[2]U.S., Renegotiation Board, Renegotiation Act of 1951 as Amended Through October 24, 1968 (Washington, D.C.: Government Printing Office, 1968), pp. i-ii. This publication contains the original Act of 1951 and all subsequent changes.

[3]Ibid., pp. 13-14.

> with respect to individual contracts, but with respect to the receipts or accruals under all renegotiable contracts and subcontracts of a contractor in the contractor's fiscal year. The contracts may vary in form from cost-plus-a-fixed-fee to firm fixed-price; they may be prime contracts or subcontracts; and they may relate to a variety of products and services. Also, they may be performed over differing periods: some may be completed within a single fiscal year of a contractor, while the performance of others may extend beyond such year. Accordingly, aggregate renegotiable profits in a given fiscal year of a contractor will often reflect the performance of several contracts in different stages of completion, and may result from an offset of losses or low profits on some contracts against high or even excessive profits on others. Thus fiscal-year renegotiation, which deals with aggregate profits, is entirely different from price adjustment or redetermination of individual contract prices pursuant to contract provisions.[1]

In addition to losses on contracts offsetting profits on others, if a contractor suffers a loss on his entire renegotiable business, he may carry this loss forward and apply it to his renegotiable sales for that year. Prior to 1956, this provision was not in effect, and a contractor who may have been in the position of incurring a large loss in one year and a large profit in another would be liable for renegotiation of the profit year without being able to take advantage of the loss.[2]

Because of certain exemptions, some contractors are excluded partially or entirely from renegotiation. Among the mandatory exemptions are the following types of contracts and subcontracts: (1) those with Territories, States, or foreign governments, (2) those for agricultural commodities in their

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[1]Renegotiation Board, Thirteenth Annual Report, p. 3.

[2]Renegotiation Board, Renegotiation Act of 1951 as Amended Through October 24, 1968, pp. ii, 6.

"raw or natural state" (eggs, fish, milk, animals, etc.), (3) those for the products of mines, oil or gas wells, and forests, (4) those with common carriers for transportation, or with public utilities for gas, electricity, or water, provided that the rates charged are not in excess of those allowed by the public regulatory agency, (5) those with organizations exempt from taxation under section 101(b) of the Internal Revenue Code, (6) those which the Board determines do not have "a direct and immediate connection with the national defense," and (7) those for an article or service which is determined to be a "standard commercial article" or a "standard commercial service."[1]

Historically, the most difficult of the above exemptions to apply and the ones that have caused the most controversy have been the standard commercial article and service exemptions. Simply stated, if a contractor sells an article or service to the government which he also sells to other non-defense purchasers, he is allowed to exclude from his renegotiable sales the revenues accrued from the sale, provided that he sells at least 35 per cent of the product to the non-government purchasers.[2] As an example, if a manufacturer were to sell 650,000 bolts to the government at a price of $1 per bolt and another 350,000 bolts to non-government buyers, the

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[1] Renegotiation Act of 1951, sec. 106.

[2] With the passage of P.L. 90-634, this percentage was increased to 55 per cent on all sales received after October 24, 1968. This increase was considered a partial victory by proponents of renegotiation who have been trying for years to eliminate entirely this particular exemption.

$650,000 would be deducted from the contractor's other renegotiable sales. An additional benefit here has been that if, by applying this exemption, the contractor's sales were below the $1 million floor, he would not have to file a report to the Board and thus would escape any review.

The exemption is self-applied by the contractor when there is only a single article involved as in the preceding example. If there is a class of similar articles, an exemption may be granted for the entire class, but only upon application to and approval by the Board. In fiscal 1967, contractors who filed reports with the Board indicated self-application of the exemption in the amount of $772.6 million, and for fiscal 1968, this amount was $860.2 million. The corresponding figure for fiscal 1965 was $561 million, indicating that increased Vietnam procurement has influenced the contractors to claim more exemptions.[1] Table 7 shows the applications for the commercial exemption that have been received by the Board.

Of interest in this table is that the amount of exemptions applied for in 1968 increased 91 per cent over those of 1967. This increase cannot help but add fuel to the arguments of the renegotiation proponents that exemptions are costly to the government in that more of them are being approved, thus reducing the effect of the Board. The table shows $5.7 billion in exemptions that have been approved since 1951. Add to this the several billion in self-applied exemptions and the unknown self-applied amount from contractors who were below the floor,

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[1] House, Extension of Renegotiation Act, Hearings, pp. 17-18, 35.

and the result is probably in excess of $15 billion.

TABLE 7

APPLICATION FOR COMMERCIAL EXEMPTION[a]
(Sales in Thousands of Dollars)

	Applications	Amount Applied for	Amount Approved	Amount Denied
Through June 30, 1966	1,815	$4,211,630	$3,926,912	$284,718
Fiscal Year 1967	251	671,901	636,611	35,290
Fiscal Year 1968	387	1,281,929	1,223,812	58,117
Total	2,453	$6,165,460	$5,787,335	$378,125

[a]Source: Renegotiation Board, Twelfth Annual Report, p. 13, and Thirteenth Annual Report, p. 14.

In addition to the mandatory exemptions, the Board, in its discretion, can exempt from some or all provisions of the Renegotiation Act the following: (1) any contracts to be performed outside the territorial limits of the United States, (2) contracts under which the profits can be determined with reasonable certainty when the contract price is established (example--lease and license agreements), (3) any contracts where, in the opinion of the Board, the provisions are otherwise adequate to prevent excessive profits, (4) any contract the renegotiation of which would violate secrecy which may be required in the public interest, and (5) any other contracts where it is not administratively feasible to segregate the profits attributable to such contracts from activities not subject to renegotiation.[1]

To some people, the exemption provisions of the

[1]Renegotiation Act of 1951, sec. 106(d).

Renegotiation Act have been nothing but convenient loopholes for contractors; to others, they have been necessary additions to a law that is basically distasteful to begin with. Regardless of the view taken, the mere processing of the paperwork connected with exemptions has been an additional increase in workload, both for the Board and for the contractors who invoke the exemptions.

Proceedings Before the Board

The first step in the renegotiation process is for the Board to send out various forms and questionnaires for the contractors to fill out concerning their renegotiable business. Appendix A contains a reprint of the standard package. Contractors who are not on the mailing list of the Board can obtain the same forms from field offices of the Department of Commerce or from the regional boards.

Contractors not above the floor of $1 million are not required to file a "Standard Form of Contractor's Report for Renegotiation" (RB Form 1) with the Board but may do so if they wish. Many contractors take advantage of this provision; in fiscal year 1968, the number of below-the-floor filings received was 2,328.[1]

Even though a contractor may be under the statutory floor and thus not required to file a report, the Board can require that he furnish certain financial data, and a failure to do so can result in a fine of "not more than $10,000 or imprisonment for not more than one year, or both."[2] The Board

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[1] Renegotiation Board, Thirteenth Annual Report, p. 6.

[2] Renegotiation Act of 1951, sec. 105(e)(1).

would normally do this where it had reason to suspect that a contractor was self-applying more than the allowable exemptions or not reporting all his receipts and accruals for a fiscal year. However, the application of this provision has been quite infrequent due to the tremendous workload in processing just the required filings (see Table 4).

To try to alleviate this problem of contractor dishonesty and to concurrently do away with the necessity of trying to determine which contractors to check, there is a provision in the latest amendment to the Act to the effect that all contractors that apply self-exemptions which cause their renegotiable sales to fall below the minimum are required to file either a "Statement of Self-exemption" or a "Statement of Non-applicability of the Renegotiation Act."[1]

In addition to requiring financial information from the contractors, the Board has the right to audit the books and records of contractors subject to the Act. These audits are normally conducted in conjunction with or by Internal Revenue personnel so that duplication of effort is avoided and economies are effected.[2]

The second step in the process involves reviewing all the contractor filings which have been sent to the Board in Washington. The voluntary filings (below-the-floor) are

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[1] Renegotiation Board, Renegotiation Act of 1951 as Amended Through October 24, 1968, p. 12. The second statement referred to is contained in Appendix A; the Statement of Self-exemption has not been published except in summary form in U.S., Renegotiation Board, Regulations, Federal Register, XXXIII, no. 218, November 7, 1968, 16340.

[2] Renegotiation Act of 1951, sec. 105(e)(2).

reviewed for acceptability and usually nothing further is done with them. Above-the-floor filings are either "cleared without assignment" or are assigned to the regional boards for further processing. Once a clearance is issued, the case is not reopened unless there later appears evidence of fraud. The Board has a one-year limitation imposed on it to either clear a case or assign it to a regional board.[1] Table 5 shows that the great majority of filings processed are cleared without assignment.

The third and most complicated step in the process is involved with the processing of the cases by the Eastern and Western Regional Boards and the final processing and/or review by the Board. This important step is where renegotiation per se is conducted. The regional boards review the forms as submitted by the contractor and will request such additional information as deemed necessary. The regional board personnel may visit the contractor's plant to obtain verification of certain items. After the field visits are conducted, the personnel assigned to the case will fill out and submit to the full regional board a "Report of Renegotiation." The Board will make a tentative determination as to whether the contractor will be cleared or whether there are excessive profits involved.[2]

A renegotiation conference is set up with the contractor and the personnel that worked on the "Report of

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[1]U.S., Code of Federal Regulations, Title 32, Chapter XIV, sec. 1473.1.

[2]U.S., Code of Federal Regulations, sec. 1472.3.

Renegotiation." The contractor is allowed to present any relevant material at the conference, and the proceedings are informal and confidential. During this stage, the evaluation of the contractor's business takes into account the statutory factors concerning excess profits which are listed in Chapter II. The consideration of these factors is not restricted by formulae or regulations from higher authority, although many would argue that there should be some consistency in their application.

At the conclusion of the conference, the determination is either finalized or modified by the regional board. If the contractor agrees with the determination, no further meetings are necessary, and a formal agreement will be drawn up which is binding on the contractor once it has been approved. If the contractor does not agree with the ruling, a unilateral order will be issued. This order essentially states that the contractor has been found to have received excessive profits of a certain amount and that he is in debt to the government for such amount.[1]

Tables 8 and 9 indicate that most determinations result in bilateral agreements between the Board and the contractor (89.5 per cent). Out of the 399 unilateral orders that have been issued, some 152 have been appealed to the Tax Court. Thus more than half of the unilateral orders are agreed to by the contractors without going to the courts.

In class A cases (more than $800,000 of renegotiable

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[1] Ibid., sec. 1475.1.

profits), the regional boards have no authority to make agreements or issue unilateral orders; they can only make recommendations to the Board in Washington as to final disposition of the case. For class B cases (less than $800,000 of renegotiable profits), the regional boards do have the authority to make agreements and issue orders, although the orders are subject to appeal as set forth below.[1]

TABLE 8

NUMBER OF DETERMINATIONS[a]

	Total	By Agreement	% of Total	By Order	% of Total
Through June 30, 1967	3,755	3,375	89.9	380	10.1
Fiscal Year 1968	46	27	58.7	19	41.3
Total	3,801	3,402	89.5	399	10.5

[a]Source of Tables 8 and 9: Renegotiation Board, Thirteenth Annual Report, p. 12.

TABLE 9

AMOUNT OF DETERMINATIONS
(In Millions of Dollars)

	Total	By Agreement	% of Total	By Order	% of Total
Through June 30, 1967	$952.44	$682.33	71.6	$270.11	28.4
Fiscal Year 1968	23.07	6.20	26.9	16.87	73.1
Total	$975.51	$688.53	70.6	$286.98	29.4

[1]U.S., Code of Federal Regulations, sec. 1472.3. See also Renegotiation Board, Thirteenth Annual Report, p. 4.

There are three types of cases that can be reassigned from the regional level to the headquarters Board: (1) all class A cases, regardless of the regional board's determination, (2) class B cases which involve unilateral orders, whether or not appealed by the contractor, and (3) any case that the Board desires to review, regardless of the class.[1]

Class A and B cases which are forwarded to the Board are assigned to one of the divisions at headquarters. The division looks over the record of the case to date and makes additional requests for information if deemed necessary. The contractor has another chance to appear and is usually issued a "Notice of Points for Presentation." The Notice advises the contractor of the particular items that the division will take up at the conference and requests that the contractor be ready with such information as well as anything additional he would like to present. After the meeting, the division submits to the full Board its recommendations for disposition of the case. The Board is in no way constrained by what has happened previously at the divisional or regional board level and can clear the contractor, or increase or decrease the determination of excessive profits against him.[2]

At this headquarters stage, the contractor has the choice of making an agreement with the Board or appealing the ruling to the Tax Court of the United States. The contractor has ninety days in which to file an appeal with the court, and

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[1] U.S., Code of Federal Regulations, sec. 1472.4.

[2] Ibid.

failure to do so automatically voids any other avenue of appeal.[1] Appeals to the Tax Court have not been very numerous or profitable to the contractors. Tables 10 and 11 provide data on cases appealed.

TABLE 10

RENEGOTIATION CASES IN THE TAX COURT[a]

	Total Filed	Dis- missed	Closed by Stipulation	Closed by Re- determination	Pend- ing
Through June 30, 1967	142	49	33	29	31
Fiscal Year 1968	10	4	2	3	1
Total	152	53	35	32	32

[a]Source for Tables 10 and 11: Renegotiation Board, Thirteenth Annual Report, pp. 13-14.

TABLE 11

TAX COURT ACTION ON BOARD DETERMINATIONS

Court Action Ending in--	Total	Upheld	Modified Upward	Modified Downward	Amount of Board Determinations	Amount of Court Redeterminations
Dismissal	53	53	..	..	$ 49,157,525	$ 49,157,525
Stipulation	35	2	4	29	83,093,411	74,464,056
Redetermination	32	17	2	13	33,465,000	32,096,000
Total	120	72	6	42	$165,715,936	$155,717,581

There have been 120 cases decided in the Tax Court, and the court has upheld $155 million of the amount originally

[1]Renegotiation Act of 1951, sec. 108.

requested by the Board. Although there have been forty-two cases in which the amount was "modified downward," the $10 million represented is not a great amount when compared to the $165 million originally requested.

A 1962 amendment to the Act of 1951 provided that appeals of Tax Court decisions could be made to The United States Courts of Appeals on questions of law only. To date, no such appeals have been made.[1]

As mentioned before, the proceedings of renegotiation at both the headquarters and regional level are confidential and not open to anyone except Board members and the contractor under consideration. Transcripts are not released and the public rarely finds out the names of companies that are undergoing and have undergone renegotiation. For many years, the contractor himself was not even allowed a written statement of why excessive profits were attributed to him, but now the Renegotiation Regulations state that a contractor is entitled to a statement of why a particular ruling was reached at any level in the proceedings.[2] However, this statement is not admissible in court as proof of anything connected with renegotiation.

The public does become aware of renegotiation proceedings when an appeal is made to the Tax Court. Here the proceedings are open and published as in most other courts of law. Publicity during a court appeal is an intangible benefit to either the contractor or the Board. Most of the publicity

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[1] Renegotiation Act of 1951, sec. 108A as amended by P.L. 87-520, 87th Cong.

[2] U.S., Code of Federal Regulations, sec. 1472.3-1472.4.

seems to emanate from the aggrieved contractor, and if the contractor reaches the public first with his arguments, the Board is usually forced on the defensive. A famous case which made trade press headlines back in the 1950's was that of the Boeing Airplane Company.[1]

In 1955, Boeing was ordered by the Board to refund $10 million in excess profits realized on contracts in 1952. This determination was made by the full Board after the Los Angeles Regional Board had cleared the company. Boeing appealed the order to the Tax Court in November, 1955, and made the most of the attendant publicity. William Allen, president of the company said, "I submit that there is no surer way to kill incentive than to have one branch of the government offer a contractor increased earnings for superior performance and then have another branch of the government take these earnings away several years later."[2] The company also cited the Board's lack of consistency in determinations and its supposedly unorthodox use of several criteria in evaluating net worth. Other aircraft companies joined Boeing in publicly speculating as to what procedures the Board was following when it overturned the regional board's decision.[3]

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[1] Boeing Airplane Company v. Renegotiation Board, 37 T.C. 613 (1962).

[2] "Renegotiators Ordered Industry to Refund $33.6 Million in 1957," Aviation Week, December 30, 1957, p. 24.

[3] G. J. McAllister, "Renegotiation Confuses Profit Outlook," Aviation Week, November 7, 1955, pp. 12-13. See also: G. J. McAllister, "Reversals Blur Renegotiation Picture," Aviation Week, November 14, 1955, pp. 18-19, and Robert Hotz, "The Renegotiation Puzzle," Aviation Week, November 14, 1955, p. 158.

The Board tried to counter the adverse publicity by having the Director of the Office of Review, Carl Huyette, state that "there can't possibly be a definite yardstick under the Act that we must administer. Every case is completely different with new factors and circumstances that we must base our rulings on."[1]

In this case, publicity notwithstanding, Boeing was ordered to refund not the $10 million originally determined, but $13 million. It was apparent that the Tax Court had looked at the case more closely than the Board originally had, and that perhaps publicity was not as beneficial as some may have thought.

In an editorial entitled "Study in Contrasts," The Nation reported that the incident should have received publication in the lay press as well as the trade press in order that the exploitation of the government and the taxpayers by Boeing be disseminated to all the taxpayers. The point made was that apparently the ordinary citizens were interested only in matters of "blood, underwear, and sports," and they could care less about matters of law. The final comment was that due to the wholesale lack of interest in the whole affair, the elected Representatives would probably change the Renegotiation Act to make this type of exploitation legal and proper.[2]

The final step in the renegotiation process is the actual collection of the excessive profits due. Section 105(b)

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[1] McAllister, "Renegotiation Confuses Profit Outlook," p. 12.

[2] "Study in Contrasts," The Nation, February 3, 1962, p. 91.

of the Act of 1951 delineates the methods of eliminating excessive profits:

> (A) by reductions in the amounts otherwise payable to the contractor under contracts with the Departments, or by other revision of their terms;
> (B) by withholding from amounts otherwise due to the contractor any amount of such excessive profits;
> (C) by directing any person having a contract with any agency of the Government, or any subcontractor thereunder, to withhold for the account of the United States from any amounts otherwise due from such person or such subcontractor to a contractor, or subcontractor, having excessive profits to be eliminated, and every such person or subcontractor receiving such direction shall withhold and pay over to the United States the amounts so required to be withheld;
> (D) by recovery from the contractor or subcontractor, or from any person or subcontractor directed under subparagraph (C) to withhold for the account of the United States, through payment, repayment, credit, or suit any amount of such excessive profits realized by the contractor or subcontractor or directed under subparagraph (C) to be withheld for the account of the United States; or
> (E) by any combination of these methods, as is deemed desirable.[1]

The process seems fairly complicated, judging from the language of the law, but the collection procedure is actually fairly simple. The Board directs the Secretary of the Department involved to collect the excessive profits from the contractor. The Secretary then applies one of the above methods, and the money recovered (if cash) is assumed by the Treasury as Miscellaneous receipts. If the money is recovered in the form of withheld payments, the appropriation of the particular department is reduced accordingly.[2] The purpose of this procedure is to insure that no one department benefits from a

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[1] Renegotiation Act of 1951, sec. 105(b)(7).

[2] Ibid.

contractor's having to refund excessive profits.

One point that should be made is that all recoveries of excessive profits are made after credit for income tax is allowed to the contractor. Renegotiation is a before-tax process--a fact that has caused considerable complaint over the years. While the Board may show determinations of, say, $15 million during a year, the actual amount recovered by the government may be $8 million or less, depending on the tax rate.[1]

Although proceedings before the Board may result in many millions of dollars refunded to the government, there is yet another way the benefits of the Renegotiation Act are received. This is through the voluntary refunds and price reductions made to the government by the contractors. In fiscal 1967, the amount involved was approximately $30 million, or some $15 million more than the excess profits determined by the Board.[2] For fiscal 1968, the figures were $15 million and $23 million, respectively.[3] These price reductions and refunds are wholly voluntary and are to be distinguished from reductions made under the terms of price-redeterminable contracts. It would be naive to say that the Renegotiation Act alone was the sole cause of the reductions, but its effect cannot be discounted. Some $1.3 billion has been refunded in this way since 1951;[4] however, there may be an even larger, though

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[1] Ibid., sec. 105(b)(8).

[2] Renegotiation Board, Twelfth Annual Report, p. 9.

[3] Renegotiation Board, Thirteenth Annual Report, p. 10.

[4] Ibid.

non-estimable figure involved in another facet of the deterrent effect of the Act. Wilbur Mills, Chairman of the House Ways and Means Committee, testified to this point in 1966:

> One of the most important results of this law lies in the restraints it imposes upon contract pricing. Procurement officials have told us repeatedly that renegotiation has aided in the negotiation of closer prices, especially in the subcontract areas not subject to direct government control. The contractor who knows excessive profits will have to be refunded is more likely to agree to what we might later describe as a reasonable price.
>
> As I have already indicated, there is no way to ascertain the savings that accrue to the government as a result of the deterrent influence exerted by renegotiation, but there is every reason to believe that the amount may be large.[1]

Results

This section will be devoted to presenting certain tables which illustrate the magnitude of the task which the Renegotiation Board has had to perform during its existence. Table 12 indicates the amounts that the Board determined as excessive profits over a 16-year period.

The total amount indicated in Table 12 includes State income tax adjustments, but not credits for Federal income tax. The net recoveries to the government through June 30, 1968, have been $382,706,358. This may seem a small sum indeed when compared to the World War II net figure of $4 billion, but it should be recognized that procurement policies and procedures have improved, thus resulting in closer cooperation with and supervision of contractors. The variance in the yearly determinations has caused much discussion, especially in Congress.

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[1]As quoted by Lawrence Hartwig in House, Extension of Renegotiation Act, Hearings, p. 16.

TABLE 12

EXCESSIVE PROFITS DETERMINATIONS[a]

Fiscal Year	Total
1953	$ 19,970,771
1954	119,463,169
1955	167,256,288
1956	152,649,327
1957	150,991,300
1958	112,724,199
1959	60,757,877
1960	52,708,003
1961	17,200,093
1962	7,844,467
1963	10,069,536
1964	24,160,028
1965	16,146,803
1966	24,513,962
1967	15,980,214
1968	23,069,748
Total	$975,505,785

Note: The above total includes determinations of $33,185,470 made pursuant to the 1943 and 1948 Acts.

[a]Source: Renegotiation Board, Thirteenth Annual Report, p. 11.

The Board has answered most of the questions concerned with these variances by referring interested persons to the following paragraph in the Thirteenth Annual Report:

> The annual record of determinations for the period covered in the foregoing table [Table 12] was influenced by several factors. As late as 1958, determinations made by the Board reflected the high profits attributable to the emergency procurement conditions of the Korean conflict. In the early part of the period, cost-plus-a-fixed-fee contracts (which generally carry lower profits than other types of contracts) were used on a relatively small scale. Subsequently, however, the use of such contracts increased. Thus, although in recent years procurement agencies curtailed the use of CPFF contracts, CPFF sales still represented 14.3 per cent of the total of $38.8 billion renegotiable business reviewed by the Board in fiscal 1968. Another factor was the curtailment of the Board's jurisdiction through increases in

the statutory floor and the enactment of various exemptions.[1]

Tables 13 and 14 show to some extent the continuing effects of a changing procurement policy. The percentage of CPFF contracts declined from 18.2 per cent in fiscal year 1967 to 14.3 per cent in fiscal 1968, and the incentive-type contracts shown in Table 14 have become voluminous enough to be removed from the "other" category appearing in previous reports. It would seem to indicate that procurement agencies are moving toward use of fixed-price and incentive contracts and away from the cost-plus type.

Out of the $38.7 billion in renegotiable sales reviewed last year, $35.2 billion, or 91 per cent, involved contractors that reported net renegotiable profits, and $3.5 billion, or 9 per cent, involved contractors that reported net losses. The comparable figures for fiscal 1967 were $28.9 billion (87.3 per cent) and $4.2 billion (12.7 per cent). Thus there has been a decline from 1967 to 1968 in the amount of "loss" sales. The number of "loss" contractors has also declined from 735 in fiscal 1967 to 676 in fiscal 1968. Caution must be exercised in trying to prove the profitability of defense business by comparing these figures, however. As the Board states:

> Renegotiable business, as a whole, is composed of manufacturing, construction, service, and other activities connected with the national defense and space programs, often undertaken on contract terms which differ from terms used in commercial business, and under different circumstances. These activities are carried on by a

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[1] Renegotiation Board, Thirteenth Annual Report, p. 11. For an interesting interchange between Chairman Hartwig and Representative James Burke (Mass.) on this point, see: House, Extension of Renegotiation Act, Hearings, pp. 29-32.

TABLE 13

RENEGOTIABLE SALES REVIEWED IN FISCAL 1967, BY CONTRACT TYPE[a]
(In Millions of Dollars)

	Total		Prime Contracts		Subcontracts		Mgmt. Fees	
	Amount	%	Amount	%	Amount	%	Amount	%
Fixed Price	$17,288	52.2	$10,877	43.9	$6,409	77.1	$ 3	9.7
Cost-plus-fixed-fee	6,020	18.2	5,286	21.3	731	8.8	3	9.7
Other	9,816	29.6	8,623	34.8	1,169	14.1	25	80.6
Total	$33,124	100.0	$24,875	100.0	$8,309	100.0	$31	100.0

Note: Details do not add to totals because of rounding.

[a]Source: Renegotiation Board, Twelfth Annual Report, p. 7.

TABLE 14

RENEGOTIABLE SALES REVIEWED IN FISCAL 1968, BY CONTRACT TYPE[a]
(In Millions of Dollars)

	Total		Prime Contracts		Subcontracts		Mgmt. Fees	
	Amount	%	Amount	%	Amount	%	Amount	%
Fixed Price	$22,449	57.9	$14,714	50.8	$7,734	78.9	$ 1	6.2
Cost-plus-fixed-fee	5,556	14.3	4,884	16.9	672	6.8	0	.0
Fixed Price Incentive	3,962	10.2	3,488	12.0	474	4.8	0	.0
Cost-plus-incentive-fee	4,664	12.0	3,970	13.7	693	7.1	0	.0
Other	2,142	5.5	1,897	6.6	231	2.4	15	93.8
Total	$38,773	100.0	$28,952	100.0	$9,804	100.0	$16	100.0

Note: Details do not add to totals because of rounding.

[a]Source: Renegotiation Board, Thirteenth Annual Report, p. 8.

> variety of companies that are either wholly, partially, or only nominally in the defense or space fields. The commercial operations of such companies may or may not be comparable to their renegotiable business. Moreover, the statutory floor and various exemptions in the Act annually exclude from renegotiation several billions of dollars of defense sales of unknown profitability. These factors, together with wide variances in the profit experience of contractors, significantly limit the value of any generalization, on the basis of the data reported here, about the profitability of defense business as a whole or of the $38.8 billion of renegotiable sales reviewed by the Board in fiscal 1968.[1]

The Board has apparently felt it necessary to insert the above paragraph after the data on renegotiable sales in the annual report because there has been a continuing controversy over just what defense producers make as a profit compared to private industry. For every study that claims that defense profits are too high, there can be found another that says defense profits are too low. The Board is caught in the middle and thus must try to take a neutral position by merely reporting the facts and withholding public interpretation of them.[2]

One final statistic to present concerning results of renegotiation is that since the Board's inception, expenses attributable to its operation have been some $52.9 million.[3] For the last six years, the Board has been averaging approximately $2.5 million per year. Proponents of the Board have added the after-tax recoveries to the government from renegotiation ($382.7 million) plus the after-tax savings from voluntary price

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[1] Ibid., p. 10.

[2] One of the most widely quoted studies showing that defense producers make lower profits than anyone else is Logistics Management Institute, Defense Industry Profit Review, LMI Task 66-25 (Washington, D.C.: LMI, 1967).

[3] Renegotiation Board, Thirteenth Annual Report, p. 15.

reductions and refunds ($537 million) and have divided by the expenses of the Board ($52.9 million) to arrive at a ratio of about $17 of recoveries to each dollar of Board expense. But this figure is not entirely free of objection. Representative Charles Gubser (Calif.) has stated that for the years 1963 to 1967, renegotiation resulted in a net loss to the government. He bases this estimate on an assumption that the cost of preparing and processing renegotiation filings is .06 per cent of the renegotiable sales. By manipulating this cost factor, Gubser comes up with a net loss of $27.7 million to the taxpayer.[1] Thus the controversy as to exactly what the actual results of renegotiation are continues on.

Summary

The Renegotiation Act of 1951, enacted March 23, 1951, was derived from the previous Renegotiation Acts of World War II. The Act created, as a new agency of the executive branch of the Government, the Renegotiation Board. The Board, composed of five members and (initially) several hundred supporting personnel, was a direct descendant of the War Contracts Price Adjustment Board, and is theoretically more independent than the latter agency.

The Board is headquartered in Washington, D.C. and has two regional boards to assist in the processing of cases. The number of personnel attached to all the boards has varied from a high of 742 in fiscal 1953 to a low of 178 in fiscal 1967. Historically, increases in personnel have lagged behind

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[1] House, Extension of Renegotiation Act, Hearings, p. 68.

increases in workloads. Since the Board has been a temporary agency since its inception, Congress has not responded to its needs in as timely a manner as with permanent agencies.

The Board has also had trouble attracting public support for its operations due to its behind-the-scenes nature. Renegotiation is a confidential process, and the public does not often learn of the Board's specific accomplishments in individual cases except through cases appealed to the Tax Court.

Renegotiation applies on a total basis to contractors having more than $1 million of renegotiable sales with any of several government agencies during a fiscal year. The law is replete with exemptions that may be self-applied by the contractors or granted by the Board. The application of the various exemptions, along with the floor of $1 million, operate to relieve many contractors from renegotiation.

In addition to being confidential, the renegotiation process is also fairly complicated. There are normally four steps or phases involved:

1. A contractor files a form (RB FORM 1) with the Board in Washington.

2. The Board reviews the filing and either clears it or assigns it for further processing to one of the regional boards.

3. The regional board gathers additional evidence and, depending on whether it is a class A or B case, will make a final determination or will recommend to the full Board what the disposition of the case should be. The contractors can appeal unilateral decisions of the Board to the Tax Court, and, in certain circumstances, to the United States Courts of Appeal.

4. Once a case is finalized, the collection of excessive profits is made by any of several methods.

Voluntary price reductions and refunds account for a sizeable proportion of the amount the government receives from operations under the Renegotiation Act. There may be even a larger amount received in the form of better contract pricing due to the deterrent effect of the law.

Results of renegotiation are not easy to determine. Depending on which viewpoint is held, monetary results can vary from positive to negative. What may be the only true test of the results of renegotiation is the fact that it is still law, and apparently will remain so for some time to come.

CHAPTER IV

PROBLEMS OF RENEGOTIATION

Introduction

This chapter will review some of the major problems associated with the Renegotiation Act of 1951. Different views will be presented with the objective of trying to show that there is no simple, clear-cut, entirely acceptable solution to all the problems of renegotiation. Most of the problems discussed are not new; the same ones have been discussed in practically every hearing before Congressional committees concerned with renegotiation since 1942. Some of the protagonists have changed, however. For instance, since 1951 the aerospace industries have assumed from the weapons and munitions producers a role as the most powerful and influential industry voice in matters of renegotiation. Supporters of renegotiation have changed somewhat also. During the 1950's, the Defense Department was an avid and enthusiastic proponent of renegotiation, and, in fact, at several Congressional hearings, DOD witnesses presented and justified the case for renegotiation. DOD still supports renegotiation in principle, but has left the task of presenting and justifying it to the Board and to some Members of Congress.[1]

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[1]The Defense Department is in a peculiar position with respect to renegotiation. If DOD were to support it in a forceful manner (by testimony), attention would be called to the

The problems to be treated are not wholly separable, but for purposes of discussion, two general classifications will be used, following the presentation of Weston in his book, Procurement and Profit Renegotiation:[1] (1) lack of standards, and (2) unfair procedures.

The Problem of Standards

Under this classification can be grouped the following subproblems:

1. Renegotiation lacks standards for defining excessive profits.

2. Adequate rewards for efficiency have not been provided.

3. The limitations of cost accounting data require an exercise of judgment for which the renegotiation process is not equipped.

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fact that the Department's procurement methods were not working and that thus renegotiation was necessary to catch any mistakes resulting. The Department does, however, support renegotiation to a limited extent with the argument that it provides an overall view of a contractor's business in contrast to the contract-by-contract review provided by the Department. In this connection, see the following: Letter to John J. Martin from J. M. Malloy, Deputy Assistant Secretary of Defense (Procurement), in House, Extension of Renegotiation Act, Hearings, 1968, pp. 42-43; U.S., Congress, House, Committee on Ways and Means, Extension of the Renegotiation Act, Hearings before the Committee on Ways and Means, House of Representatives, on the General Subject of an Extension of the Renegotiation Act, 86th Cong., 1st sess., April 27-29, 1959, pp. 4-48.

[1] J. Fred Weston, ed., Procurement and Profit Renegotiation (San Francisco, Calif.: Wadsworth Publishing Company, Inc., 1960), pp. 7-11. This book is a compilation of the issues and ideas that evolved from a discussion of background papers presented at a seminar held on profit renegotiation at the University of California, Los Angeles, on May 18-19, 1959. The seminar was attended by representatives of industry, the academic world, and the Renegotiation Board.

4. Practicable profit standards are available but not used by the Renegotiation Board.[1]

Each of these subproblems will be discussed in turn.

Excessive Profits

Since the first Renegotiation Act (1942), there has been controversy as to what precisely constitutes excessive profits. The problem has two facets--one theoretical and the other practical. The theoretical aspect has to do with questions of how to define excessive profits, and further, how to determine whether a company meets the definition. The practical side involves the actual end result of the determination: are the profits really excessive, or, phrased another way, do the refunds that are made by the companies affect their capital position? As is evident, the dividing line between the two sides is still indeterminate, and the questions are so closely interrelated that the answer to one depends on the other.

By law, the Board is required to take into account six statutory factors in its determination of excessive profits. These factors (enumerated in Chapter II) have not changed since their adoption into law in 1943. A common criticism has been that no specific weight has been attached to the six factors. In other words, some feel that more attention should be given to the "efficiency" factor (for example) rather than to the "extent of risk assumed" factor.[2] An amendment to the Act was

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[1] Ibid., p. 7.

[2] House, Extension of the Renegotiation Act, Hearings, 1959, pp. 202-03.

reccommended in 1959 by the Department of Defense which provided for the Board to indicate in any statement given to the contractor its "consideration of, and the recognition given to, the efficiency of the contractor or subcontractor and each of the foregoing factors."[1]

Included in the same amendment was the proposed addition of a seventh factor:

> Types and provisions of contracts with the Departments and subcontracts, with particular regard to contractual pricing provisions and the objectives sought to be achieved thereby, including especially, in the case of contracts and subcontracts containing provisions for incentive payments, the nature and extent of cost reductions effected thereunder and the extent to which such reductions are the result of the efforts of the contractor or subcontractor.[2]

This proposed factor was partially designed to ameliorate the complaints of contractors and industry officials that the incentive profits they were rightfully earning under DOD contracts were being taken away by the Renegotiation Board on the basis of its aggregate review.[3] This proposal would also have the effect of having the Board do a contract-by-contract review of a contractor's business--a procedure for which renegotiation was not designed.

Thomas Coggeshall, Chairman of the Renegotiation Board

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[1] Ibid., p. 3.

[2] Ibid.

[3] This controversy had its beginning in the Boeing case previously referred to and was furthered along by other aircraft companies that claimed the Board did not properly recognize their incentive profits. For a discussion of this point, see: "Renegotiators Ordered Industry to Refund $33.6 Million in 1957," pp. 24-25; Hotz, "The Renegotiation Puzzle," p. 158; "Proposed Renegotiation Changes Broaden Industry Appeal Rights," Aviation Week, May 18, 1959, p. 29; "Bill to Extend Renegotiation Act Protested by Republican Group," Aviation Week, May 25, 1959, p. 30.

in 1959, stated the following concerning adoption of the proposed factor:

> The Renegotiation Board has always endeavored to give proper consideration to the pricing objectives of the contracting parties, but I agree that the matter is of sufficient importance to warrant its being denominated a separate factor of equal dignity with the others enumerated in the law.[1]

Two years later, however, the Board's position was that the amendment was unnecessary since the substance of it had been incorporated in the Board's regulations in 1958.[2] The amendment was not passed in 1959, nor have similar ones been passed to date.

The present position of the Board concerning the statutory factors is related in the Thirteenth Annual Report:

> It is apparent from the statutory language that no formulae or pre-established rates can be used to determine whether profits are, or are not, excessive in any given case. Rather, the determination in each instance must reflect the judgment of the Board on the application of each of the statutory factors to the facts of the case.[3]

The above statement is purposely broad, but not unreasonably so, according to Chairman Hartwig:

> The Act sets forth these factors which are good economic factors. The broad provisions enable the Board

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[1]Thomas Coggeshall, "Basic Principles of Renegotiation," in Procurement and Profit Renegotiation, p. 48.

[2]U.S., Congress, Joint Committee on Internal Revenue Taxation, Report on the Renegotiation Act of 1951, H. Doc. 322, 87th Cong., 2d sess., 1962, p. 76. The 1959 House Hearings contain letters from the Renegotiation Board to contractors that supposedly fulfill the requirements of the law and of the proposed amendment. The section on efficiency will present some of these letters. The citation is House, Extension of the Renegotiation Act, Hearings, 1959, pp. 230-252.

[3]Renegotiation Board, Thirteenth Annual Report, p. 5.

> to carry out the national policy against excessive profits in such a manner that the efficient producer, the reasonable cost producer, is not penalized. . . . In other words, the act is purposely broad so that the Board may differentiate between the efficient and the inefficient producer, the high-cost and the low-cost producer. This is one feature of this act that makes it equitable, and is one reason why renegotiation has withstood the test of time, more than 25 years, as compared with a flat profit limitation statute such as Vinson-Trammell, which is repressive.
>
> This kind of statute is not repressive. It is a judgment operation, but I think sometimes that we have not sufficiently emphasized the fact that there are analytical tools available for analyzing the reasonableness of profits.
>
> Just to illustrate what I mean, usually when excessive profits arise there is a sudden or abnormal change in the ratios that businessmen look at to determine whether profit is fair. When we see a change or increase in ratios we go into the factors to determine why it occurred.
>
> If an increase in profit occurred as a result of the contractor's efficiency, the act says we must take this into account. If the increase in profit resulted from lower cost, we must take this into account. . . . It isn't as difficult as it may seem because when you look at the ratios you have a flag immediately and you go into the case, and investigate and study it, and you determine by comparison of this company with its past, this company with its competitors, whether under the factors--after giving the contractor full credit for contribution to the defense effort, efficiency, reasonableness of costs, et cetera--whether it has made excessive profits or deserves a clearance.[1]

In other words, the Board uses other tools besides the statutory factors in reviewing a case before it, and these tools compensate somewhat for the lack of preciseness in the factors. The industry view of the statutory factors is, as may be expected, quite the opposite from the Board's. The Machinery and Allied Products Institute testified to this point in 1959:

> Although the statute enumerates a list of factors to be taken into consideration, there is no indication of relative importance as among these factors. Inherently, the factors are so broad in their terms and the grant of

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[1] House, Extension of Renegotiation Act, Hearings, 1968, pp. 35-36.

> discretion so unlimited that for all practical purposes no restrictions are placed on the Board. By its very nature the process of determining excessive profits is fundamentally and inescapeably arbitrary.
>
> In an individual case, for example, a contractor in discussions with the Board may stress efficiency and cost saving to the Government; the Board makes a refund determination; the contractor in a later hearing argues that efficiency and cost saving have not been rewarded at all, or to a proper degree; the Board contends the factor has been given due weight. How can this difference of opinion be settled in the Tax Court or anywhere else? And even more important, how can the contractor prevail on court appeal when he has the burden of proof as to the Renegotiation Board's determination and confronts grounds which he cannot ascertain.[1]

Chapter III made reference to the fact that there is conflicting opinion as to whether or not excessive profits really exist in defense-oriented industries as compared to other industries. Added to this question is that of whether or not the refunds that are made by companies that have undergone renegotiation have harmed them in any way. During the hearings in 1959, the Board submitted a series of statistical exhibits which showed for the years 1950-55 the effect of renegotiation refunds upon the earnings and net worth of each of the ten leading airframe manufacturers.

The renegotiation refunds reduced the total of $586 million profits by $53 million, while the combined net worth of all the companies increased $338 million, or 113 per cent, during the five-year period. This increase was after the payment of all dividends, taxes, renegotiation refunds, and sales of capital stock. Another interesting statistic is that the ten companies were able to increase their renegotiable sales from

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[1] House, Extension of the Renegotiation Act, Hearings, 1959, p. 133.

$828 million in 1950 to $4.5 billion in 1955 with an investment of only $155 million in contractor-owned fixed assets. On the other hand, government-owned fixed assets which were provided to the companies increased $533 million during the same period.[1]

Based on the above information (and much other data not repeated here), the Board concluded that the financial positions of none of the companies was in any way jeopardized by renegotiation refunds, and that the defense contractors were making more on their investment that non-defense contractors.[2]

The president of the Machinery and Allied Products Institute, Charles W. Stewart, presented data at the same hearings which showed in his words "generally lower profit levels." Table 15 shows these data.

Stewart's point was that the figures show that profits for the machinery industry have been steadily declining since the pre-Korean War period and that this was indicative of the fact that there were no excess profits in these industries.

To bring the practical question of defense industry profits up to date, two more authorities will be cited. One, which is used by most opponents of renegotiation, is the 1967 study done by the Logistics Management Institute, a non-profit research organization retained by former Secretary of Defense Robert McNamara. The following is the first paragraph from the "Summary Findings" of the study:

> 1. The average profit as a per cent of capital investment, of high and medium volume companies, has been lower for the past five years on their defense

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[1] Ibid., pp. 109-22. [2] Ibid., p. 109.

TABLE 15

RELATION OF PROFITS (AVERAGE) AFTER TAXES TO STOCKHOLDERS' EQUITY AND TO SALES[a]

	To Equity (Profit Ratio)				To Sales (Cents on Dollar)			
	1947-50	1953-56	1957	1958	1947-50	1953-56	1957	1958
All Manufacturing	14.6	11.3	11.0	8.6	6.7	4.8	4.8	4.1
Machinery:								
Nonelectrical	14.0	10.3	10.7	7.1	7.1	4.8	4.8	3.8
Electrical	16.9	12.2	12.6	10.3	6.3	4.2	4.2	3.8
Transportation equip.:								
Motor veh. and parts	20.7	15.6	14.2	8.2	7.4	5.2	5.4	3.6
Aircraft, ships, etc.	6.7	14.9	..	..	3.4	3.4	3.4	..

[a]Source: House, Extension of the Renegotiation Act, Hearings, 1959, p. 150.

> business than on their commercial business and also lower than the average profit on capital of companies included in the FTC-SEC sample. The trend of profits on defense business of these companies since 1958 has been downward while that on their commercial business and the FTC-SEC sample has been upward.
>
> Net profit on Total Capital Investment (TCI) was 6.9 per cent on defense business in 1966. The corresponding ratio for defense contractors' commercial business was 10.8 per cent. . . .
>
> Between 1958 and 1966 defense profit/TCI ranged from a high of 10.2 per cent in 1958 to a low of 6.3 per cent in 1964 and stood at 6.9 in 1966.
>
> Profit to TCI on the commercial business of defense contractors ranged from a low of 4.7 per cent in 1961 to a high of 11.6 per cent and stood at 10.8 per cent in 1966.[1]

The opposite view is taken by Murray Wiedenbaum of Washington University. In a study he conducted he found that defense contractors typically show a relatively low profit rate on sales, but their return on investment is high because they have large infusions of government-provided equipment and capital ($14.7 billion in 1967).[2] His sample of big defense companies showed a 17.5 per cent return on investment in the period 1962-65. The comparable ratio for non-defense contractors was 10.6 per cent.[3]

The main point of the preceding discussion is that profit figures show basically whatever the user wishes them to. A layman without an accounting background would be hard pressed to try to correlate any of the totals and other information that

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[1] As quoted in House, Extension of Renegotiation Act, Hearings, 1968, p. 102.

[2] William K. Wyant, Jr., "Can Defense Profiteering Be Halted? Experts Wonder," The Pilot, January 25, 1969, p. 8. See also William K. Wyant, Jr., "Control of Defense Industry Profits," The Pilot, January 11, 1969, p. 8.

[3] Frank C. Porter, "Defense Contractors Make More, Hill Told," The Washington Post, November 12, 1968, p. A2.

has been presented either in this paper or in the various hearings before Congress. Generally, each major witness that appears for each side during the hearings has had unimpeachable data showing either the lack of, or surplus of, profits attributed to defense industries, or manufacturing in general. Probably in most cases the data that are presented to the Committee members are true--at least in relation to the purpose for which the data was originally collected. However, by changing terminology, it is entirely possible to reduce profits to losses where there were originally "excessive profits." The following view of Admiral Rickover could be applied to either side in the renegotiation fight without much loss of credibility:

> Profits are not necessarily what they seem to be, particularly when based on data volunteered by contractors who may exploit the figures as they choose.[1]

Efficiency

Efficiency is one of the statutory factors and, as such, is closely related to the problem of excessive profits previously discussed. However, a separate section is accorded this factor because it has been the subject of so much debate over the years.

The excerpt of the Renegotiation Act of 1951 which deals with efficiency is as follows:

> In determining excessive profits favorable recognition must be given to the efficiency of the contractor or subcontractor, with particular regard to attainment of quantity and quality production, reduction of costs, and economy in the use of materials, facilities, and manpower.[2]

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[1] Wyant, "Can Defense Profiteering be Halted?" p. 8.

[2] Renegotiation Act of 1951, sec. 103(e).

The main questions concerned with the efficiency problem have been the alleged lack of reward given to the contractors because of their efficiency, and further, the incentive impairment due to the lack of reward.

From the earliest days of the Act of 1951, the Board has tried to convince contractors that they will be suitably rewarded for their cost-cutting and other processes of efficiency. In an interview conducted with a Board member in 1952, Aviation Week determined that a defense contractor that demonstrates unusual efficiency, with resultant savings to the government, would reap an award according to his achievement.[1]

Barron K. Grier, representing the Aircraft Industries Association, testified in 1959 before the Ways and Means Committee that although the Boards appeared to be giving favorable recognition to the efficiency factor, there did not appear to be any reward for this efficiency. He submitted for the record letters received by several aircraft companies from the Renegotiation Board which outlined the basic reasoning for the Board's determinations. Excerpts pertaining to the efficiency question follow:

(Letter dated March 22, 1957 to North American Aviation, Inc.)

Efficiency

The contractor's long established record of low cost production as measured by man-hours per pound expended is again present in the year under review and this fact is

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[1] "Efficiency Will Pay in Renegotiation," Aviation Week, June 16, 1952, p. 49.

confirmed by procurement agencies.[1]

(Letter dated July 12, 1957 to Lockheed Aircraft Corporation)

Efficiency
The contractor has delivered a wide variety of high-quality products. It has also demonstrated a good control over utilization of manpower and materials.[2]

(Letter dated May 13, 1957 to Douglas Aircraft Corporation, Inc.)

Efficiency
The contractor is recognized as a producer of high-quality products with a record of maintaining delivery schedules. It has satisfactorily demonstrated a good control of manpower and materials.[3]

These segments of the letters to the various companies are essentially similar in that they are generalized, short, and non-committal as to the reward to be received by the contractor. It was letters such as these that prompted contractors and others to back the amendment proposed in 1959 that would require more definite recognition of efficiency in letters to the contractors. The Board did not wait for the amendment, however. The following letter is reproduced as a representative sample of the type of letters that the contractors began receiving approximately one year after the above letters were received:

(Letter dated June 10, 1958 to North American Aviation, Inc.)

Efficiency
The contractor states that comparisons of its fighter planes production performance with the 1954 industry

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[1] House, Extension of the Renegotiation Act, Hearings, 1959, p. 237.

[2] Ibid., p. 245. [3] Ibid., p. 252.

average indicate, in terms of the standard industry measure of efficiency--man-hours per airframe pound--that it was at least 10 per cent more efficient than the average aircraft manufacturer at comparable points in production on comparable programs.

The contractor also states that its more efficient production performance was achieved despite labor shortages involving certain essential skills, rising wage rates, and higher material costs.

Comment: The contractor's claims to efficiency, as measured by labor man-hours per pound of airframe, have been verified by procurement agencies.

The contractor has submitted examples of its efficiency in the year under review which it claims are capable of measurement as dollar savings, as follows:

1. Economy in buying through combining purchase orders resulted in a savings of $10 million.

2. Encouraging competition and competitive practices among its suppliers resulted in a saving of $200,000 by the placing of a new order for F-100 landing gear with a second source.

3. Use of price redetermination contracts with suppliers, utilizing cost analysis and learning curves, resulted in refunds of $2 million to the Los Angeles division.

4. Use of multipurpose tools designed by the contractor on one particular contract saved $36.000.

The Board has given consideration to these claims, as well as to others of a more general nature made by the contractor.[1]

This letter is much longer, and more specific, than the previous ones. However, it still is very non-committal. In essence it is nothing more than a listing of the contractor's claims and a statement that the Board has given them consideration. Efficiency is recognized, but no weight is explicitly attached to it. There was a weight implicitly attached, however, because of the fact that in all the companies listed, efficiency was recognized favorably, and yet each company had, in the opinion of the Board, excessive profits. In fact, all the statutory factors were rated favorably for each company with the exception of risk and net worth. In other words, according to

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[1] Ibid., p. 233.

the Board, because about 70 per cent of the total fixed assets were government-supplied, the risk to each company was quite low, thus offsetting the rewards for efficiency and the other statutory factors.[1]

The final paragraph from a letter to one of the aircraft companies illustrates the point that while no specific quantitative weight is attached to the application of the statutory factors, there is nevertheless some type of weight attached, and this weight is determined most probably in the minds of the members of the Renegotiation Board.

(Letter dated February 13, 1959 to Lockheed Aircraft Corporation)

> Reasonableness of Profits
> Notwithstanding the decrease in sales and profits from the prior year and the contractor's acknowledged efficiency and lowered costs, the Board has concluded that the contractor's renegotiable profits, accompanied as they were by substantial government assistance and subcontracting as well as the minimal risks to which the contractor was exposed by reason of 94.9 per cent of its production being either CPFF or fixed price incentive, are greater than can be considered reasonable.[2]

The second part of the basic efficiency controversy is incentive impairment. Contractors complain that under an incentive contract they do their best to cut costs and save the government money (while at the same time making a larger profit), only to have the Board take away these incentive profits as well as part of their basic profits through renegotiation. It will be recalled that earlier in this chapter mention was made of an amendment proposed in 1959 to require the Board to take into special consideration the types of contracts performed by

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[1] Ibid., pp. 243, 245. [2] Ibid., p. 243.

companies that were subject to renegotiation. The following testimony of Representative Carl Vinson pointed out why the proposed amendment should not have been adopted:

> Section 2(a) purports to set up an additional factor pointed specifically at incentive-type contracts which would require special consideration of these contracts. I have already discussed with you the chart that shows the profits made by seven of the airframe companies who have incentive-type contracts and who today are appellants in the Tax Court following decisions made by the Renegotiation Board.
>
> Now, these same companies obviously would benefit in the future from the language contained in this proposed section. But aside from these companies that can be identified today, and others not identifiable, this language would put incentive contracts in a different status from other contracts as a source of excessive profits. Special recognition suggests special exemptions. This I oppose.
>
> Under the present law, the Board is required to consider cost reductions and the efficiency of the contractor.
>
> That being the case, either this section is a devious provision to give a special exemption or it is redundant and unnecessary, since the same consideration of cost reductions and contractor effort are considered under existing law.[1]

The Ways and Means Committee recommended that the Renegotiation Act be extended in 1959 for four years and, in disagreeing with this proposal, nine Republican members of the Committee added some weight to the contractors' incentive impairment complaints by saying that one of the serious problems that had to be solved concerning renegotiation was that the

> term "excessive profits" required further statutory definition in light of the Renegotiation Board's alleged practice of seeking to recapture normal profits on contractually agreed-upon incentive profits.[2]

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[1] Ibid., p. 189.

[2] "Bill to Extend Renegotiation Act Protested by Republican Group," Aviation Week, May 25, 1959, p. 30.

This same incentive problem was afforded recognition by the Joint Committee on Internal Revenue Taxation in its 1962 study of renegotiation. However, the Committee declined to make any specific recommendation about this problem, preferring instead to recommend that the Act of 1951 be extended for only a two-year period. The Committee's reasoning was that the Board itself was conducting its own study of renegotiation and therefore would presumably come up with its own solutions to its own problems.[1]

The two opposing views concerning the stifling of incentives to efficiency are best presented by the following excerpts from papers presented at the renegotiation seminar held in 1959:

> It is asserted that renegotiation stifles efficiency and low-cost production. For purposes of illustration, the proponents of this contention are prone to refer to the Board's approach to incentive-type contracts. The claim is made that the contractor, by introducing efficiencies into his operations, cuts costs below the agreed target level and thereby entitles himself under the contract provisions to share in the resultant savings, only to have the Renegotiation Board come along at a later date and take back his entire "bonus for savings." . . . I shall not belabor the point that an incentive contract is no better than the target cost upon which the operation of its incentive formula depends. Experience has shown that target costs, which necessarily are based in part upon estimates of future costs, are often substantially inaccurate. Clearly, therefore, the possibility of excessive profits is present, and neither the incentive contract in its entirety nor the incentive profits alone should be exempted.
>
> Suffice it also to say that incentive profits as such are not eliminated by the Board. A determination of the Board is based upon an evaluation of the contractor's entire profits under incentive contracts during the fiscal year, not just the profits realized under the incentive formula, and upon a review of profits from all other renegotiable business performed by the contractor under

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[1] House, Report on Renegotiation, H. Doc. No. 322, pp. 10-11.

other types of contracts. Any numerical similarity between incentive and excessive profits, if it exists at all, is purely coincidental.[1]

The most discouraging experience of the airframe industry under renegotiation has revolved around incentive profits. At the heart of the incentive-type contract is the desire of the military to effect savings in cost. Use of the incentive contract is based on the hope that the ultimate cost to the government will be less than it otherwise would be; and if it is less, the profit allowed to the contractor will be greater. . . . Major segments of the airframe industry have effected substantial savings in cost to the government under incentive contracts and at the same time, according to the terms of their contracts, they have enhanced their own profit position. This saving pleased the military, but the Renegotiation Board, which is only interested in profits, was not greatly impressed. To the Board, a profit is a profit; whether it is a basic profit or an incentive profit makes no difference. As a result, some of the major companies in the airframe industry had excessive profit determinations equaling and in some cases exceeding their incentive earnings. The Board maintains that this was just a coincidence. Nevertheless the Board has often demonstrated an unfriendly attitude toward incentive contracts and has at times minimized their value by suggesting that an overstated target rather than genuine contractor effort could lead to incentive profits.[2]

Cost Accounting Procedures

A discussion of this problem can best be prefaced by a statement by Gillette in his article, "Accounting Aspects of Renegotiation": "The application of accounting principles to the renegotiation process produces a monstrosity because it is an attempt to reconcile concepts that are irreconcilable."[3]

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[1]Coggeshall, "Basic Principles of Renegotiation," pp. 51-52.

[2]William T. Darden, "Business Experience with Renegotiation," in Procurement and Profit Renegotiation, p. 65.

[3]Charles G. Gillette, "Accounting Aspects of Renegotiation," in Procurement and Profit Renegotiation, p. 109.

According to Gillette, there are four kinds of accounting concepts involved in the renegotiation process: (1) generally accepted accounting principles which are the standard principles employed by public accounting firms as well as most private accountants; (2) income tax accounting wherein the firm tries to legally delay the paying of taxes as long as possible; (3) cost accounting wherein the cost of an article is known at every stage of its production; and (4) the determination of contract costs under military contracts.[1]

The main complaint of the contractors appears to be that since income tax accounting is usually done on an annual basis, the government has therefore decided that renegotiation will also apply on an annual basis and consequently "that the fairness of income should be determined annually."[2]

Gillette states the contractors' point of view as to why yearly accounting and the renegotiation process do not mesh:

> Representatives of the Department of Defense and the contractors sit down together and make price determinations or price redeterminations on contracts that run for as long as five years. In so doing, they also take into consideration performance and pricing on preceding contracts and sometimes on anticipated follow-on contracts. After this is done, renegotiation pulls out the fragment of such a contract which happens to be accrued in a given year, adds it to similar fragments of other contracts all in accord with accounting principles differing from those used by the parties in the contract negotiation, and then makes a determination that the profits thereon are excessive. On the basis of such determinations, we hear in the halls of Congress that this proves the Department of Defense is making mistakes in its pricing and that, therefore, the Government needs the renegotiation process to protect itself from its mistakes. Yet, the accounting considerations that entered into the accounting pricing in the first place are not admissible in the renegotiation

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[1] Ibid., pp. 109-10. [2] Ibid., p. 111.

process. The two accountings can only be compared after the fact--when it is too late to make intelligent use of such comparison either in the contracting process or in the renegotiation process.[1]

There are many technical problems involved with accounting and renegotiation. Perhaps the most difficult to solve is that of the allocation of costs. The following example is cited to show in simplified form part of the complexity of the cost allocation problem and how this complexity can be interpreted incorrectly by the Renegotiation Board:

> Consider the case of a contractor who is operating his shop with 1000 people, working one shift on non-renegotiable business. The factory is producing television sets at a cost of $100 per set and has long-term commitments to deliver them at a price of $150.
>
> The contractor then receives a renegotiable order from the government for another product. In order to perform the contract on schedule, our contractor hires 3,000 people and goes on a two-shift operation. He transfers 750 of his original 1000 people to the renegotiable contract, so that his television sets are now being produced by 250 experienced and 750 new hires. The whole place is in chaos. However, we have a very conscientious timekeeping organization which meticulously counts the hours spent building television sets. When these hours are priced out and other costs added, it appears that the $150 television sets are costing $160 instead of $100.
>
> Now it happens that the president of this company is a genius and he anticipated all this right down to the penny; so, when he made the bid that produced the renegotiable contract, he priced it high enough to absorb $60 times the number of television sets he was going to make during the period of performance under the renegotiable contract.
>
> However, the accountant was just an accountant and he charged all the hours spent building television sets to the television department and charged the renegotiable contract with the hours spent performing under it. When reports were filed with the Renegotiation Board, they showed a profit of 20 per cent on renegotiable sales and a loss of 7 per cent on non-renegotiable business.
>
> Anyone with a sharply pointed pencil could draw certain conclusions from such a report, such as:

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[1] Ibid.

1. The bookkeeping was "accurate."
2. This was an inefficient contractor because he could only make money when he was subsidized by the Government. (Look at his loss when he was competing in the commercial television market.)
3. The 20 per cent profit on the renegotiable business was clearly excessive. (This contractor's normal profit was minus 7 per cent.)
4. The Government had been robbed and should get its money back.
5. The contracting officer who fixed the price on the renegotiable business was either a knave or a fool.[1]

In this example, the allocation problem worked to the contractor's disadvantage. This is not always the case, according to Admiral Rickover, who estimates that the government could save two billion dollars annually by tightening up the way cost and profit figures are worked out.[2] In an appearance before the House Committee on Banking and Currency in the fall of 1968, Rickover stated:

> We must have standard accounting practices so that the government can learn what it actually costs to make an article and what the actual profit is. The way it is today, industry can change their accounting practices at will and in any manner they wish. And, under the present rules the government can't object and doesn't have the people to check. . . .
>
> We have no way of knowing whether the cost is proper or whether it covers excess profit, subsidy for . . . commercial work, or both.
>
> Today you don't know the cost or the profit. We only know the total amount we pay. We simply don't know what we are doing.[3]

The imposition of uniform accounting standards on all contractors would be one way of attempting to get at the problem of cost allocation, but there are many that feel the government

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[1] Ibid., pp. 112-13.

[2] Wyant, "Can Defense Profiteering Be Halted?" p. 8.

[3] Ibid.

should put its own house in order first. There are presently a myriad of accounting systems in the agencies of the Federal Government, and it has been only recently that the President has directed that the entire government should go on an accrual accounting basis; it is anticipated that this system will take several years to develop and implement.[1]

Practicable Profit Standards

This topic can, in a sense, be considered as a further facet of the excessive profits problem discussed earlier in the section. The basic argument is that the Board has relied upon the judgment of men in applying the statutory factors when there has been available other, more reasonable and quantifiable factors. Weston and Jacoby have conducted a study in which they evaluated the earnings of the aircraft industry as compared to other dynamic and growing industries in 1953.[2] Their premise was that because of the high risks involved, the profit rates of the aircraft industry should at least approximate the rates of other firms with comparable risks. Four profit standards were developed and applied to the industry to see at what level their profits should have been for 1953.[3] Table 16 shows the

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[1]The proposal for accrual accounting was one of a number of recommendations made to President Johnson by his Commission on Budget Concepts in 1967.

[2]Neil H. Jacoby and J. Fred Weston, "Profit Standards for Renegotiation," in Procurement and Profit Renegotiation, pp. 121-58.

[3]These standards were first published in the Quarterly Journal of Economics, LXVI (May, 1952), pp. 224-250.

earnings to sales rate actually received as compared with what should have been received according to the four profit standards:

TABLE 16

RESULTS OF APPLICATION OF EARNINGS STANDARD TO THE AIRCRAFT INDUSTRY[a]

Actual earnings rate on sales	6.04%
Earnings on renegotiable sales (before taxes) necessary to meet the four earnings standards:	
Equity financing standard	7.62%
Market application standard	9.73%
Historical earnings standard	7.32%
Comparative earnings standard	9.92%

[a]Source: Jacoby and Weston, "Profit Standards," p. 156.

One conclusion reached by Jacoby and Weston was that by all standards, the profits for the aircraft industry in 1953 were inadequate. Another was that due to the lack of meaningful standards in the procurement process, procurement officials had been "unduly restrictive in the earnings they have permitted to the aircraft industry."[1]

The greatest value that the authors see in these standards is the application of them in the initial pricing of contracts and the continued application of them by the Board in the renegotiation process. The standards would not be rigidly applied through the use of automatic formulae, but would instead be applied through the judgment of the persons involved. The four standards would indicate a reasonable zone of profit for a firm which "rated about average on the statutory factors."[2]

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[1]Ibid., p. 157. [2]Ibid., p. 158.

Essentially then, these standards would be guidelines to the application of the statutory factors. They would still depend on judgment to make them work, but theoretically they would make the judgment decisions easier to make. The Board has not officially adopted these standards or any others; it relies on the judgment of men, applied to the statutory factors based on the circumstances in each case. As has been mentioned before, however, the Board is not without tools with which to apply its judgment. The basic function of the Office of the Economic Advisor is to conduct the types of economic studies and surveys which will be helpful to the Board in its deliberations.[1]

The Matter of Procedures

Under this category can be grouped the following:

1. Proceedings before the Renegotiation Board.

2. Proceedings before the Tax Court of the United States.

Board Procedure

In the words of the Joint Committee on Internal Revenue Taxation, "Widespread dissatisfaction has been expressed with regard to present practice and procedure of the Board."[2] Practically any industry witness appearing before Congressional committees has had something less than kind to say about the

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[1] See the Organization Chart of the Renegotiation Board which is reproduced in Chapter III.

[2] House, Report on Renegotiation, H. Doc. No. 322, p. 62.

proceedings before the Board. Some examples follow:

> . . . the process of renegotiation can never be anything but a wholly arbitrary one and one which defies rational analysis or retrospective review by appellate courts.[1]

> Usually the hearing will cover a period of two or three hours in the morning, sometimes running into the afternoon. It generally consists of the contractor coming in and giving his reasons as to why he thinks he has no excessive profits.
>
> The Board will ask questions from time to time. Rarely, if ever, does the Board bring out any of the facts that it has obtained from other sources. I can almost say categorically that it does not.
>
> After the hearing is over, the Board retires and usually on the same day comes back and says, "Mr. Contractor, your profits are excessive, in our opinion, by $10 million"--period.
>
> There is no negotiation. Generally they will not even discuss the matter with you. Nothing, I assure you, could be more arbitrary than the way in which the Board's decision is made. There is no negotiation, across the table or otherwise.[2]

> Renegotiation is an arbitrary process, which is neither necessary nor desirable in our free enterprise economy. It places a premium on inefficiency and unsound procurement administration, and it undermines the basic philosophy of our free, competitive enterprise system.[3]

There are essentially two types of grievances which are commonly stated concerning Board procedure. One group consists of those which are attributable to the lack of a clear and concise definition of excessive profits and the other of those attributable to the lack of certain procedural safeguards. Since the excessive profit problem has already been discussed, only the second type will be discussed in this section.

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[1]Charles W. Stewart in House, Extension of Renegotiation Act, Hearings, 1959, p. 131.

[2]Barron K. Grier in ibid., p. 227.

[3]Robert R. Statham in House, Extension of the Renegotiation Act, Hearings, 1968, p. 203.

Many different complaints are included in the procedural safeguard category. The findings of the Joint Committee on Internal Revenue Taxation can be used to summarize these criticisms.

One complaint has been that there is a lack of established procedures for resolution of disputes as to questions of law and fact. "Unlike procedures before the courts, there is no requirement in the renegotiation statutes that the parties make requests for findings of fact in order to frame issues on questions of law and fact."[1] To illustrate, one contractor who appeared before the Joint Committee advised that he was unable to get a hearing at the regional board level as to whether certain costs could be charged against renegotiable business. The amount of these costs was several million dollars--an amount that would have reduced the ultimate determination of excessive profits to zero. The point made by the contractor was that a "procedure for joinder and resolution of issues on questions of law and fact should not be left to the discretion of the Board.[2]

Another common complaint in this category concerns the collection of evidence used by the Board. The Board may consider any information it chooses from any source, regardless of whether or not it would be admissible as evidence in a court of law. The contractor is not entitled as a matter of right to rebut this information (if written) or to hear and confront a witness (if testimonial). The Board is not required to

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[1] House, Report on Renegotiation, H. Doc. No. 322, p. 63.

[2] Ibid., p. 64.

disclose all the information it uses, but must reveal certain parts of it when requested to do so by the contractor. The Board has remained adamant, however, with respect to releasing performance reports to contractors. These reports, along with trade secrets, income tax data, and financial statements, are all exempt from the provisions of the Administrative Procedure Act which requires government agencies to make available most of their information to the public.[1]

A third grievance in this category has been directed toward the actual decision-making process of the Board. Cases which are referred to the statutory Board from one of the regional boards are usually handled by a one-member board consisting of an Office Chief. It was found that in many instances, there was free discussion between the statutory Board members, the regional board members, and the staff members that actually prepared the government's case. In other words, the contractors have felt that they have not been receiving an impartial review from the higher levels in the renegotiation process. Their view is further reinforced by the fact that in many cases the decisions made by the statutory Board and the regional boards appear to have been pre-determined, as they were announced only a few hours after meeting with the contractors.[2]

Fourth, and finally, in this category is the complaint that the Board is not required to, and in fact does not, keep a

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[1] Ibid. See also U.S., Code of Federal Regulations, sec. 1480.9 for a list of the exemptions permitted the Board.

[2] House, Report on Renegotiation, H. Doc. No. 322, p. 65.

written record of all proceedings before it. Without a record, according to the contractors, there is no basis for citing errors of fact or law allegedly committed by the Board in the event of subsequent proceedings in the Tax Court.[1]

A few weeks before publication of the above criticisms, the Board published a letter to the Committee which outlined a new regulation to help "give renegotiation procedure clarity, certainty and uniformity."[2] This regulation contained certain features which were a partial answer to the many critics and criticisms of the renegotiation process:

> (1) Provision is made for oral and written presentation of any issues or disputed matters of fact, law or accounting, and for the resolution thereof.
> (2) The regulation provides that a copy of the accounting section of the report of renegotiation will be furnished to the contractor upon request.
> (3) Provision is made in the regulation for a notice of points for presentation. . . . The purpose of the notice is to enable the contractor to prepare for the meeting, and, in addition to presenting his entire case as he sees fit, to address himself at such meeting to particular points or matters with respect to which it is believed that presentation will be helpful to the division in its consideration of the case.[3]

There were other changes in the Board procedures designed to streamline the process, but the one change which was earnestly desired by the contractors was vigorously opposed by the Board. This change, embodied in an amendment to Public Law 86-89, and subsequently deleted in conference, would have allowed contractors access to performance reports and other

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[1] Ibid.

[2] Letter from Renegotiation Board to Hon. Wilbur D. Mills, December 21, 1961, in House, Report on Renegotiation, H. Doc. No. 322, p. 73.

[3] Ibid., p. 74.

written data furnished to the Board. The Board's comments pertaining to this amendment are worth quoting at length because they represent the basic administration viewpoint on renegotiation in general and this point in particular:

> In our opinion the Renegotiation Act of 1951 contemplates, as did the predecessor statutes, that renegotiation at the Board level is a purely administrative activity, and adjunct to the procurement process; that the Renegotiation Board is neither a judicial nor a quasi-judicial nor a semijudicial body, but is rather an arm of the Executive, seeking to eliminate excessive profits by agreement with defense contractors; and that such operations of the Board are not adversary in character and should not be burdened with the attributes of formal litigation, but should remain informal.
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> . . . . . .
>
> The Board is of the opinion that there are other important reasons why this inspection provision is undesirable legislation. The claims for the production of documents misconceive the nature of renegotiation proceedings. Whatever reasons may be thought to justify production of Board documents in Tax Court cases, those reasons do not apply to the proceedings conducted by the Board. In the informal nonadversary administrative proceedings at the Board level, there is no more reason to require the Board to open any part of its files for inspection by the contractor than there is to require the Internal Revenue Service to show its files to the taxpayer with whom it is negotiating a deficiency assessment, or to require a contracting officer to show his files to the contractor with whom he is negotiating a contract redetermination or other price adjustment. In each of these instances, when the initial informal . . . effort fails, machinery is available to the contractor to pursue his rights in another forum where he may have the full protection of formal, adversary, trial-type proceedings. . . .
>
> Other objections to compulsory production of Government performance reports are well known:
>
> (a) If these internal reports were known to be subject to inspection by the contractors to whom they relate, it is not reasonable to expect that the departmental employees who prepare them would be as candid as the situation requires.
>
> (b) These reports . . . often contain references or intimate information relating to other companies, including competitors of the contractor, to which the contractor is not entitled.
>
> (c) Realistically it must be recognized that, if performance reports were to be shown, their production would often likely be followed by demands from contractors that

> the authors of the reports be summoned to appear at renegotiation conferences for confrontation and questioning. This in turn could easily lead to demands for sworn testimony and a written record--and renegotiation would cease to be administratively manageable.[1]

It is evident that the Board is very much against having to show its documents to anyone. The next discussion will show the main reason why contractors would like to see them.

Tax Court Procedure

Critics have been no less outspoken of the Tax Court procedure than of the Board procedure. Proceedings in the court are supposed to be de novo, as required by the law, and, according to the Chief Judge of the Tax Court, the proceedings are just that.

> The trial before the Tax Court in a renegotiation case is a de novo proceeding, as the law requires. It is not a review of the action of the Renegotiation Board. The Tax Court decides each case solely on the basis of the evidence introduced in the trial before it. The Tax Court does not see or consider the proceedings of the renegotiation Board or regard anything in those proceedings as evidence before the Tax Court, with the possible exception that some evidence introduced in the renegotiation proceedings might qualify as admissible evidence before the Tax Court and be introduced into the Tax Court record by one of the parties. . . .
>
> The Tax Court has explained in its rules and opinions that the contractor must assume the burden of the moving party in the proceeding and if the proof before the Tax Court is inadequate to support an independent determination, then of course the court has to leave the parties as it found them, that is, it cannot change the determination of the Renegotiation Board.[2]

The contractors have found fault with the above procedure; their main argument has been that the proceeding is, in

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[1] Ibid., pp. 75, 78.

[2] Letter from Chief Judge J. E. Murdock to Hon. Colin F. Stam, May 15, 1961, in House, Report on Renegotiation, H. Doc. No. 322, p. 12.

fact, not de novo; and even if it were, the contractor should not have to, and in fact cannot, prove that the Board's determination is erroneous because he has no actual knowledge of the specific facts and documents which were used by the Board. One writer has even stated that the Tax Court starts a renegotiation case with the presumption that the decision of the Renegotiation Board is correct and that the presumption can be rebutted only by clear and convincing evidence to the contrary.[1] Further argument advanced by Koehler to support his contention is that the Tax Court has modified Board determinations only when it has found what it considered to be arbitrary or unreasonable actions and that the court has never cleared a contractor, whose profits the Board has determined to be excessive, on the grounds of an improper application of the statutory factors.[2] (See Table 11 for Tax Court actions on Board determinations.)

Marcus, in his article, "Appropriate Public Policy for Renegotiation," concluded of the Tax Court procedure that

> The result of all this is that today the Tax Court neither reviews completely the proceedings of the Board to determine if error has been committed, as an appellate body normally does, nor does it give a fresh full-scale hearing to the firm that has been determined to have realized excessive profits.[3]

The Board itself has generally refrained from comment on Tax Court proceedings on the grounds that the Department of Justice handles the renegotiation litigation once the Board

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[1]John T. Koehler, "Renegotiation: Evidence and Burden of Proof in Appeal Proceedings," 45, Virginia Law Review, 17 (1959), p. 2.

[2]Ibid., p. 20.

[3]Marcus, "Appropriate Public Policy," p. 192.

completes a case.[1]

Summary

Renegotiation has spawned problems ever since its beginning in 1942. Over the years the basic issues of controversy have remained fairly stable; however, the proponents and opponents have changed in some ways. Many of the problems are interrelated, and at times, a statement of an industry or Board representative can seemingly be applied to several different problems.

The "lack of standards" category was first discussed, and within it can be loosely grouped the following: (1) excessive profits definition and application, (2) lack of rewards for efficiency, (3) inappropriateness of accounting procedures, and (4) failure to use available profit standards in evaluating a company.

The controversy over the definition of excessive profits has been a long-continuing one. Amendments to the law have been proposed which would quantify the factors used in determining excessive profits and which would add another factor to the six presently in use. None of these amendments have become law. There is further controversy as to the effect of renegotiation on the earnings of companies and as to the profitability of defense industries as compared to other industries.

The efficiency problem has provoked almost as much discussion as that of excessive profits. The main problem has been the apparent lack of reward for efficiency and the supposed

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[1]House, Report on Renegotiation, H. Doc. No. 322, p. 78.

diminishing of contractor incentives due to the alleged failure of the Board to give "proper" consideration to the efficiency factor. The Board has denied industry contentions about this problem.

The other two problems in the first category have not received the attention that the first two have, but nevertheless are frequent topics of discussion, particularly at industry conferences and Congressional hearings.

The second classification treated has been that of unfair procedures, including those before the Board and the Tax Court. Industry has generally classified Board procedure as "arbitrary" and has made several complaints concerning evidential procedure and the decision-making process of the Board. The Board has changed some of its regulations to make the renegotiation process more equitable and certain, but it has consistently refused to make available for contractors' inspection performance reports and other data of a confidential nature.

Proceedings before the Tax Court have been characterized as not being de novo, as required by law, and of being biased in favor of the Renegotiation Board. The Tax Court itself denies these claims, and the Board has not issued a policy statement on Tax Court procedure since it sees its responsibility in a case as ending when the contractor appeals to the Tax Court.

CHAPTER V

THE FUTURE OF RENEGOTIATION

Introduction

The previous chapters have dealt with the history, process, and problems of renegotiation. This chapter will outline some of the principal proposals for change to, or repeal of, renegotiation and will conclude with a short summary of the pro and con positions toward renegotiation.

Modification to Renegotiation

There have been three main categories of proposals to change the present renegotiation process:

1. Raise or lower the statutory "floor."
2. Increase or decrease the allowable exemptions.
3. Remove the renegotiation process back to the contracting departments whence it came originally.

Raise or Lower the Statutory "Floor"

The minimum amount subject to renegotiation was raised in 1953 to $500,000 and in 1956 to $1 million.[1] Since 1956, there have been several proposals to raise this amount to $5, $10, and even $20 million. Two main reasons have been advanced in favor of these proposals: (1) small businesses would be

[1]Renegotiation Board, Renegotiation Act of 1951 as Amended Through October 24, 1968, p. 13.

exempted to a greater degree than they are now, thus promoting more subcontracting by prime contractors; and (2) there has been a general rise in the price level since the last increase in the "floor."[1] The Board has consistently opposed raising the "floor" for the reason that a substantial number of their excessive profits determinations have been against contractors reporting renegotiable sales between $1 and $5 million. To raise the "floor" would automatically exclude a substantial portion of the Board's business.[2] Another reason that the Board has given for opposing any increases in the "floor" is that

> small business, merely because it is small, should not be relieved from the obligation it would otherwise have to refund profits from defense contracts which are excessive and as such contrary to national policy.[3]

There have also been a number of proposals to lower the "floor" to $500,000 or to the Korean War level of $250,000. Even though the number of filings would increase at the reduced level,[4] the Board has maintained the position that the "floor" should remain at $1 million because that is what the administration desires.[5]

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[1]For further amplification of these reasons, see the following: House, Report on Renegotiation, H. Doc. No. 322, pp. 59-60; House, Extension of Renegotiation Act, Hearings, 1968, pp. 6, 10-11, 105, and Hearings, 1959, pp. 128-29; Weston, Procurement and Profit Renegotiation, p. 167.

[2]House, Extension of Renegotiation Act, Hearings, 1968, p. 10.

[3]Ibid., p. 6.

[4]Chairman Hartwig estimated that with a "floor" of $250,000, reviewable sales would increase some $4 billion in 1969.

[5]House, Extension of Renegotiation Act, Hearings, 1968, p. 27.

Increase or Decrease the Allowable Exemptions

The exemptions referred to are not those pertaining to standard commercial articles and services (discussed in Chapter III), but rather to those having to do with the different types of contracts. Industry has urged exemptions for incentive, redeterminable, and competitively bidded contracts. Many feel that the main benefit to industry in these exemptions is that the proposals will encounter less resistance than a proposal to repeal renegotiation in its entirety. In other words, industry has adopted a strategy of attacking renegotiation piecemeal from within the broad confines of the law itself.[1] The main argument for enacting the contract exemptions is that the three types of contracts are already so closely supervised that there is no need for the Board to take them into account after their completion.[2]

Bills to provide an exemption for competitively bidded contracts were introduced by Representative Abraham J. Multer in 1958 and again in 1967 (H.R. 13561 and H.R. 3100, respectively). Since the bills were practically identical, the Board submitted as its 1968 position, the letter that it had submitted on August 1, 1958 in opposition to H.R. 13561. The following excerpt pertains to the competitively bidded contract:

> The proposed exemption is based on the premise that formal advertising and competitive bidding in accordance with the requirements of the Armed Services Procurement Act of 1947 will always prevent excessive profits. This premise, in the opinion of the Board, is not sound. It

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[1] Marcus, "Appropriate Public Policy," p. 194.

[2] Ibid.

> has been the experience of the Board, and we believe of the Department of Defense, that many of the uncertainties which justify renegotiation may in fact prevail in areas in which it is appropriate to use formal advertising and competitive bidding procedures. This is substantiated by the fact that in a substantial number of cases coming before it the Board has found excessive profits in contracts let as a result of competitive bidding. The principal cause of such profits is that a bidder, although striving to bid the lowest possible price, must base his bid upon an estimate of costs to be incurred plus some provision for contingencies. It is obvious that his estimate may exceed the costs actually thereafter incurred, and it is equally obvious that the contingencies which bidders provide for will often never occur. The fact that there are three or more bidders does not change these inherent reasons why there may be excessive profits in competitively bid contracts.[1]

Representative of the bills introduced to exempt incentive contracts is one that was introduced by Senator Leverett Saltonstall (S. 500) in 1959. The Senator pointed out that the incentive contract, as well as fixed-price and competitively bid contracts, were types that were designed to produce prices which did not include payments to the contractor of excessive profits. In other words, if these contracts were executed and audited properly, there would be no need for renegotiation.[2]

The Board's position on exempting incentive contracts has been previously stated. Basically it was that an incentive contract is no better than the target cost upon which the operation of its incentive formula depends, and for this reason incentive contracts should not be exempt from renegotiation.

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[1] House, Extension of Renegotiation Act, Hearings, 1968, p. 10.

[2] Horace H. Hopkins, "Possible Modifications in the Renegotiation Law," in Weston, ed., Procurement and Profit Renegotiation, pp. 165-66.

The redeterminable type of contract has in its original terms a provision whereby the price can be adjusted up or down after a certain amount of cost experience has been obtained. Proponents of this exemption claim that excessive profits are less likely to occur in such contracts that have been, and will be, subject to practically constant review by the contracting activities.[1]

Opponents of this exemption basically hold the view of former chairman Coggeshall that price revision provisions can only be written into a contract if the contractor agrees to them and that if a contractor knew he would not get renegotiated should he refuse to accept such price revisions, he would probably be less than cooperative.[2]

Move the Renegotiation Process to the Defense Department

There have been several proposals through the years to abolish the Renegotiation Board and transfer its functions back to the Department of Defense where an organization similar to the Military Renegotiation Policy and Review Board of 1948 would again be created. The very existence of the various proposals to move the Board gives rise to the question of why was the Board created in the first place. The hearings conducted in 1951 provide an answer: "Only the creation of a separate agency will insure the objective business judgment and the

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[1]House, Extension of Renegotiation Act, Hearings, 1968, p. 7.

[2]Coggeshall, "Basic Principles of Renegotiation," p. 52.

uniformity of decision so essential to the fair and equitable administration of renegotiation."[1] The implication of this reason is that the Renegotiation Board was created to review the actions of procurement officials. Although this may be an indirect purpose of the Board, it is by no means the most important. The Board directs its actions against contractors who realize excessive profits--not against the agencies that made the contracts with the suppliers. The Board leaves to the General Accounting Office the task of overseeing the contracting policies of the various procurement agencies.[2]

Marcus sums up the prevalent feeling concerning the transfer of renegotiation to another department:

> Renegotiation would not necessarily be improved by transferring it back to the Department of Defense which administered the Renegotiation Act of 1948 or to all the interested contracting departments in the manner of the wartime renegotiation statutes. It is probable that the effect of such a move, even if acceptable to the departments concerned, would not change present procedures very much. The inevitable professionalization of renegotiation that has already been noted makes it unlikely that its policies would be greatly affected by the contracting agencies even if renegotiation were made a responsibility of those agencies.[3]

Repeal the Renegotiation Act

This particular proposal and its opposite (make renegotiation permanent) have caused perhaps the most fundamental

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[1] U.S., Congress, House, Committee on Ways and Means, Renegotiation Act of 1951, H. Report No. 7, 82d Cong., 1st sess., 1951, p. 3.

[2] House, Extension of Renegotiation Act, Hearings, 1968, pp. 61-62.

[3] Marcus, "Appropriate Public Policy," pp. 194-95.

conflict of the entire renegotiation controversy. Advocates of repeal base their arguments on the "inescapable arbitrariness of renegotiation" and the existence of "newly developed procurement techniques."[1]

The procurement techniques normally referred to are embodied in the 1962 Truth-in-Negotiations Act (Public Law 87-653) which was passed partly because of the recommendations of the House and Senate Armed Services Committees. These two Committees were conducting a study of Department of Defense procurement procedures at the same time that the Joint Committee on Internal Revenue Taxation was conducting its study of renegotiation.[2]

Public Law 87-653 requires that prime contractors or subcontractors submit cost or pricing data and certify in writing as to the accuracy of the data in any contracts for over $100,000.[3] The law also provided for the contract price to "be adjusted to exclude any amounts by which it was increased due to the submission of cost or pricing data which was inaccurate, incomplete or noncurrent."[4] To check on the accuracy of the data, a contracting officer may request audits of contracts which he believes may be suspect. As a further precaution, the

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[1]Coggeshall, "Basic Principles of Renegotiation," p. 50.

[2]House, Report on Renegotiation, H. Doc. No. 322, p. x.

[3]General Accounting Office, "Need for Improving Administration of the Cost or Pricing Data Requirements of Public Law 87-653 in the Award of Prime Contracts and Subcontracts in the Department of Defense," (Washington, D.C.: General Accounting Office, January, 1967), p. 3.

[4]House, Extension of Renegotiation Act, Hearings, 1968, p. 42.

Department of Defense conducts a program of reviews and audits to insure that the data are accurate.[1]

Critics of renegotiation rely on the Truth Act as the main basis for their position of repealing renegotiation. The standard reasoning put forth is that how could there possibly be any excessive profits when each contract that is made with Defense is scrutinized closely to insure that the profit made is reasonable? Representative Gubser said about the Truth Act in 1968 that

> It is being strengthened every day. The Truth-in-Negotiations Act is a relatively new tool which renders the renegotiation process even more obsolete. Furthermore, as recommended by our committee, the Department of Defense is continuing to sharpen the effectiveness of the tool. . . . [The Act] accomplishes anything which the Renegotiation Board can possibly claim as a reason for its existence.[2]

With all the provisions of the Truth-in-Negotiations Act and the laudatory testimony thereto, it would seem that procurement procedures in the Department of Defense have progressed to the point where the Renegotiation Board is no longer needed.

Apparently, such is not the case. There are many indications that the Truth Act is not working effectively. One unfavorable report is from the General Accounting Office, which in 1967 found that 102 out of 141 prime contracts had cost and pricing data which was inadequate or not submitted in writing. In some cases the contractor certified that data was complete, but the agency involved had no record of what the data was! In other cases, contractors were exempted from submitting data by

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[1] Ibid., p. 43.

[2] Ibid., p. 73.

the contracting officer because, in the officer's opinion, the gathering and furnishing of the data would impose too much of a workload on the contractor.[1]

Another critic of the Truth Act has been Representative Charles A. Vanik (Ohio):

> Some would argue that the Board does not need to be strengthened because of the Truth-in-Negotiation Act, which was passed in 1962. It has become clear, however, that this Act is not succeeding in its purpose. It took the Department of Defense five years to implement the audit provisions of the Truth Act. Nor are the procedures set up under the Truth Act administered by an independent agency like the Renegotiation Board; rather, they are administered by officials whose impartiality can be questioned. . . . Just this March 8th, the Hardy Subcommittee released a report on its review of defense procurement procedures, policies, and practices with special emphasis on truth in negotiations. The report made a number of recommendations urging the Defense Department to tighten up its negotiation transactions, which, to date, have been unsatisfactory.[2]

Perhaps the most aggressive proponent of renegotiation outside of the government has been Sanford Watzman of the Cleveland Plain Dealer. He wrote a series of articles in 1966-1967 which took to task the Department of Defense for its failure to use the Truth Act. Subsequently, Watzman joined forces with Representative Gonzalez in marshalling support for the Board.[3]

Some opponents of renegotiation have admitted that while procurement procedures were lacking in the Defense Department,

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[1]General Accounting Office, "Pricing Data Requirements," pp. 10-15.

[2]House, Extension of Renegotiation Act, Hearings, 1968, p. 26.

[3]See Ibid., pp. 119-175 for reproductions of Gonzalez' and Watzman's speeches and articles concerning renegotiation.

renegotiation was not the answer. Representative Thomas B. Curtis made the following points in the hearings in 1968:

> The issue, as I see it, . . . is how to best ride herd on these contracts. Is it, as I would argue, to continue trying to develop a better procurement policy within the Defense Department, through laws and through techniques, or to use the device of an independent board such as the Renegotiation Board to get at this? The Renegotiation Board in my judgment served the purpose when they had to follow crash procurement practices because you didn't have time to do it in an orderly way. But hopefully, and I emphasize "hopefully," we have gotten to the point where we don't have to use crash procurement practices. The procurement policies we presently follow on paper, if the laws are endorsed, will get at the very thing we are talking about.
>
> Now, our hearings last year revealed a woeful lack of compliance by the military establishment with the truth in procurement laws and the testimony of the General Accounting Office revealed this.
>
> Now, the Renegotiation Board certainly contributed nothing in doing all this. Nor would it catch any of this because the Renegotiation Board in its testimony reveals that it does no auditing.[1]

The argument for making the Renegotiation Board permanent is best stated by the Chairman in a letter to the Speaker of the House of Representatives, dated February 23, 1968:

> The continuation of statutory renegotiation for an indefinite period is considered essential in the national interest . . . because there is no foreseeable end to the conditions which make it necessary.
>
> Even if the Vietnam conflict were to end in the near future, the end of international tensions is not in sight. Hence there will be a continuing demand for new and increasingly complex aircraft, missiles, space vehicles and other specialized items; and huge purchases will continue to be made under conditions similar to those now prevailing. Market-tested prices do not and cannot exist for costly, novel, and complex military and space products. For this reason prices must be negotiated, often with sole source contractors. Such negotiated prices are necessarily based upon uncertain cost estimates because reliable cost experience is not available. Improved purchasing techniques cannot alter these basic characteristics of military and space procurement in a period of advancing technology.

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[1] Ibid., p. 89.

> Furthermore, although awards will continue to be made on a contract-by-contract basis, the profitability of the contracts cannot be known until the profits resulting from the contractor's performance of all his contracts are recorded for his fiscal year. Renegotiation provides an after-the-fact review of such profits. Thus it affords the only means for assuring that the profit outcome of procurement is reasonable.[1]

Pro and Con Positions

This section will be devoted to a summarization, by means of a sampling of pertinent statements, of the basic positions for and against renegotiation. Viewpoints represented are those of Members of Congress, Board representatives, business and industry groups, and private citizens. First to be presented will be the opposition viewpoint.

(Testimony of Charles W. Stewart, President of Allied and Machinery Products Institute):

> We feel that the Congress should go awfully slow in reenacting what I believe is the fifth extension of the 1951 Act at a time when we have none of the conditions which are characteristic, economicwise, or from the standpoint of procurement, of all-out war efforts. . . . The justification for renegotiation under present circumstances is placed before you in a wholly perfunctory manner and there is nothing new about the current justification versus the presentation made to you last year.[2]

> If a Board is so omniscient that it can determine what is an excessive profit, why can't it also determine what is an inadequate profit and offset inadequate profits against so-called excessive profits? . . . Let us put renegotiation in perspective. I have said that "Old Government agencies never die and they make every effort to avoid fading away."
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> In my judgment, this is precisely the posture of the Renegotiation Board at the present time because the

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[1] Ibid., pp. 2-3.

[2] House, Extension of the Renegotiation Act, Hearings, 1959, p. 161.

problem area to which it was addressed no longer exists. We shouldn't use an archaic, obsolete tool designed for different conditions and different circumstances to solve the problem of today when that too is wholly inappropriate and when it is also characterized by this extraordinary type of arbitrary or capricious judgment which is implicit in the renegotiation process.[1]

(Statement of the Chamber of Commerce):

The Chamber of Commerce of the United States is firmly opposed to any extension of the Renegotiation Act. Based upon studies made by its Taxation and National Defense Committees, the chamber believes that:

1. Renegotiation is an arbitrary process and is neither necessary nor desirable in our present free enterprise economy;
2. It places a premium on inefficiency and unsound procurement administration because the military services have adequate procurement techniques for controlling profits at all contracting levels;
3. It undermines the basic philosophy of our free, competitive enterprise system; and
4. Proposed amendments offer no solution to the basic problems inherent in the renegotiation process.[2]

(Testimony of Charles S. Gubser, a Representative in Congress from the State of California):

Mr. Chairman, I believe I have shown that the renegotiation process results in a net loss to the taxpayer, that it contradicts established procurement policy, that it is injurious to defense procurement and restricts the talent and ingenuity of American industry which is available to the national defense, and lastly, that the act is unnecessary.

I urge you to let this useless and obsolete act die at the end of its authorized period. In no event should it be made permanent and in no event should its jurisdiction and authority be increased.[3]

(Telegram from David Packard, Chairman, Hewlet-Packard Company, presently Deputy Secretary of Defense):

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[1]House, Extension of Renegotiation Act, Hearings, 1968, p. 94.

[2]House, Extension of the Renegotiation Act, Hearings, 1959, p. 304.

[3]House, Extension of Renegotiation Act, Hearings, 1968, p. 76.

> . . . the continued expansion of Armed Services Procurement Regulations to provide for competitive procurement of commercial items and the requirements of the Truth in Negotiations Act in negotiated procurements minimizes the need for continuation of the renegotiation act.[1]

(Letter from D. R. Williams, Vice President of Winzen Research, Inc.):

> Our main point . . . is . . . that the Renegotiation Board is trying to perpetuate itself by inferring that they are checking for excess profits on negotiated contracts when in fact they are extending their authority beyond what we believe to be the intent of Congress.[2]

(Statement of Thomas B. Curtis, a Representative in Congress from the State of Missouri):

> I don't think the Board has done much. . . . I will be very frank. I think there is a very much better way to handle this operation. . . . If you have done nothing, I know what I would do with your Board. I would get rid of all five of you. It is apparent to me why this Board has been ineffectual as it has been over a period of years. You can't even give us data that relates to the increased amount of Government procurement that is going on . . . and the Board is unaware of the discrepancies that exist in compliance with the Truth in Negotiations Act which Congress passed with the price adjustment features.[3]

The proponent view is exemplified by the following excerpts.

(Testimony of Carl Vinson, a Representative in Congress from the State of Georgia):

> The dollars that are recovered by the process of renegotiation are relatively small compared to the dollars that would otherwise be needlessly expended through overpricing and excess profits, were it not for the Renegotiation Act.

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[1] Ibid., p. 202.

[2] Ibid., pp. 218-19.

[3] Ibid., pp. 60-64.

> The Renegotiation Act is something like a vaccine; its value is not so much in the cases it cures as it is in the cases that it prevents from becoming infected. Renegotiation, therefore, induces voluntary price reduction, to avoid statutory renegotiation.
>
> Renegotiation does no more than prevent or eliminate profits that are clearly excessive and unreasonable on an over-all basis--profits that it would be clearly unconscionable for a contractor to retain from his dealings with his Government in circumstances which precluded proper initial pricing.[1]

(Statement of Former Chairman Thomas Coggeshall):

> In all the years that this controversial subject has enlivened the American scene, there has been unanimous agreement on one proposition: excessive profits on defense business have no place in our national life. Admittedly it is difficult to define and determine excessive profits, but I submit that the renegotiation law, with its all-encompassing judgment and flexibility, is the best and fairest method this country has yet been able to devise to accomplish this delicate task.[2]

(Testimony of Henry B. Gonzalez, a Representative in Congress from the State of Texas):

> The judgment of men in applying the renegotiation laws obviously works exceptionally well. It does not make sense to me to argue that simply because the judgment of men is involved the Renegotiation Act should not be made permanent.
>
> I believe that enactment of my bill would make an important contribution toward limiting profiteering. . . . The great need for opening all possible avenues to renegotiation lies in the fact that the Board is the sole and single agency which has been consistently effective in preventing war profiteering. In comparison, the history of DOD compliance with the Truth in Negotiations Act demonstrates it cannot be expected to police its own contracts.[3]

(Letter from R. W. Landies, TRW, Inc.):

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[1] House, Extension of the Renegotiation Act, Hearings, 1959, p. 182.

[2] Coggeshall, "Basic Principles of Renegotiation," p. 58.

[3] House, Extension of Renegotiation Act, Hearings, 1968, p. 187.

If there ever was a need for legislation to benefit the tax payer, it is the need for such legislation to continue the Renegotiation Board function and to grant it more power than it has at the present time. It is indeed a sad commentary that such a Board is necessary, but the fact remains that it is. . . .

If the politicians and the businessmen are unable to curb their excessive draining of our natural economic resources, then certainly we must have a control group to insure that it is kept to an absolute minimum. I am strongly in favor of supporting all legislation that will further the work of the Renegotiation Board.[1]

(Statement of Charles A. Vanik, a Representative in Congress from the State of Ohio):

The Renegotiation Board is unique in that it is the only independent agency designed to recapture excessive profits from defense, space, and other government contractors. . . .

The Renegotiation Board does not exist at the sufferance of the defense contractor; it exists at the demand of indignant taxpayers. And with the escalation of the Vietnam conflict, the demand for the Board is greater than ever. . . . I am hopeful that the Committee and Congress will, at this time, when so many young Americans are giving their lives for their country, strengthen the Board so that a few do not make "war profit killings" at the expense of the whole Nation.[2]

(From the Cleveland, Ohio Plain Dealer, January 10, 1968):

The federal government's Renegotiation Board, which has saved hundreds of millions of dollars for taxpayers, is confronted with a fight for its life. It must be saved. Not only that, it should be given new strength. Instead of ignoring this life or death matter as it has to date, Congress should be giving it close attention.

Powerful forces are at work to let the useful independent agency die a quiet death or allow it to survive only in a weakened condition.

Now is the time for responsible members of Congress to exert a powerful countervailing force on behalf of the Board and the taxpayers for whom it saves money.[3]

(Statement of Chairman Lawrence Hartwig):

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[1] Ibid., p. 219.

[2] Ibid., pp. 25-26.

[3] Ibid., pp. 151-52.

> It can be fairly concluded that renegotiation has proved itself an effective method of eliminating profits on defense and space contracts, an effective inducement to voluntary refunds and price reductions, and an effective deterrent against overpricing in the first instance. . . .
>
> The administration proposes that the Renegotiation Act be extended without termination date. In making this recommendation, we submit that there is no foreseeable end to the conditions which make renegotiation necessary.[1]

Summary

During the tenure of renegotiation, there have been several proposals to modify the process. Three of the most common have been concerned with the statutory "floor," the exemption of certain types of contracts, and the relocation of the process of renegotiation back to the Defense Department.

The last change (to $1 million) to the statutory "floor" was made in 1956. Reasons advanced for increasing the "floor" have been based on the benefits which would accrue to the small business community and the fact that prices have risen since the occasion of the last change. The Board and the administration have successfully opposed any raise as well as any increase in the "floor."

The exempting of incentive, price-redeterminable, and competitively bidded contracts has been proposed by industry as a way of attacking and weakening the power of the Board. The main argument offered is that with careful use of these contracts, there is no need for them to be included in a contractor's over-all renegotiable business. The proposals have not met with any success.

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[1] Ibid., p. 15.

With respect to the proposal to remove renegotiation back to the Defense Department, the general consensus appears to be that nothing beneficial would be gained by the transfer.

In addition to changing renegotiation, there have been proposals to repeal or make it permanent. Advocates of repeal rely on the operation of the Truth in Negotiations Act as a replacement for renegotiation. There are several indications that the Truth Act is not working, however.

Members of Congress and the Renegotiation Board have submitted that renegotiation should become permanent, for the main reason that there is no foreseeable end to the conditions which make it necessary. To date, Congress has not been convinced that renegotiation should be either repealed or made permanent but instead has continued its policy of renewal every two to three years.

The chapter concluded with a brief sampling of the comments that have been made pro and con toward renegotiation.

CHAPTER VI

CONCLUSIONS

The following are the major conclusions reached by the author:

1. Although conceived as a temporary measure during World War II, renegotiation has become, in the twenty-seven years since its inception, essentially a permanent part of national defense procurement policy.

2. However, regardless of the experience gained concerning the operations of renegotiation during this period, a better definition of excessive profits and the statutory factors concerned therewith is needed in order that more specific guidelines are made available to the contractors and Board officials alike. This would undoubtedly require changes in the law, but hopefully the benefits attributable to these changes would outweigh the disadvantages.

3. There is need also for an up-to-date review of the renegotiation process as well as a concurrent, complete study of defense procurement techniques and levels of defense contractor profits. The main arguments for and against renegotiation seem to revolve around the fact that the Defense Department is not doing as effective a job in its procurement process as it should be doing. There is a definite need for a comprehensive study in this area to encompass such questions as

the following:

a) What are the actual profits and costs of the contractors?

b) What actual cost is there to the contractors and the government as a result of the renegotiation process?

c) Does the threat of renegotiation cause closer initial pricing of contracts as claimed by proponents of the Board?

d) Should the renegotiation process remain non-adversary or should it become more like a court of law?

e) Have the objectives of renegotiation changed over the years, and does the current process meet these objectives?

f) Can the purposes of renegotiation be met by procurement techniques presently available?

4. The periodic review by Congress of the renegotiation process is important to prevent the unwise and discriminatory exercise of power by renegotiation officials. No other agency of the federal government (save the Congress through its taxing power) has the power to take away money from the private sector of the economy in the way that the Board does. The abolition of war profiteering is important, but it is equally important that due process be carried out and that the rights of all parties to renegotiation be protected.

5. Although the complaints against renegotiation have been many, the fact remains that only 4 per cent of the determinations of the Board have been appealed by the contractors to the Tax Court. It can be concluded from this that the contractors either have been willing in general to regard the Board's

determinations as "reasonable" or, if not that, then they have been reluctant to undergo further litigation in the Tax Court due to the cost and time involved, or to the apparent futility of the process.

6. The claims of opponents of renegotiation that the process results in a loss to the taxpayer should be regarded with skepticism as should be the claims of proponents that renegotiation has resulted in hundreds of millions of dollars refunded to the U.S. Treasury. The accounting and reporting systems in the government and private industry are not compatible as yet and thus neither side can state unequivocally what the results of renegotiation are.

7. The existence of renegotiation operates in some indeterminate measure as a deterrent to increased profiteering by contractors. While this deterrent effect may not be as important a justification for renegotiation as the Board's proponents have indicated, neither can it be discounted entirely, in accordance with the wish of industry opponents. It is the author's view that contractors are probably influenced by the presence of the renegotiation statutes in much the same way as they are influenced by the tax laws. Although disobedience of either set of laws may lead to greater short-run profits, the long-run effect of such disobedience will tend toward reducing the company's public reputation--an effect that most companies engaged in the highly competitive economy of today would rather not be subject to.

8. Renegotiation, like taxes, will probably never be favorably looked upon by everyone. Thus, it is necessary for

the public to rely upon the wisdom and judgment of the elected officials to insure that the points of view of private industry, the government, and the general public are taken into account in any determination as to the continued need for renegotiation. However, these officials cannot merely passively listen to the persuasive, and sometimes explosive, arguments of the opposing sides. They must instead search for unbiased facts which will allow a conscientious and fair application of the principles of government to the question of renegotiation.

APPENDIX A

THE RENEGOTIATION BOARD

WASHINGTON, D. C.

In reply refer to LPI number shown on back cover

Letter of Preliminary Inquiry

tlemen:

The attached forms and instructions are transmitted to you so that you may comply with the egotiation Act. This material is designed to help you prepare a report under the Act or deter- e that you are not required to file such a report.

To avoid possible further inquiry, the Board would appreciate being advised if you determine you are not required to file a report, and the reason therefor.

The enclosed material should be read carefully. If a filing is to be made, the appropriate ched form should be completed and filed with the Board. In order to cooperate with you in ping your work to a minimum, the Board will accept a photocopy of your work papers wherever porting data are required by the form.

This Letter of Preliminary Inquiry does not constitute the commencement of renegotiation eedings with your company.

The instructions are not a substitute for the Board's regulations, but should suffice in many s to enable a contractor to take appropriate action under the Act. The Renegotiation Board ulations (together with Renegotiation Rulings and Bulletins) may be obtained from the Super- ndent of Documents, U.S. Government Printing Office, Washington, D.C. 20402, at a sub- ption price of $6.50. The Renegotiation Board cannot comply with requests for copies of ce regulations.

All inquiries or correspondence with respect to these forms and instructions shoud be dressed to Paul T. Semple, Director, Office of Assignments, The Renegotiation Board, Wash- gon, D.C. 20446.

Sincerely yours,

Lawrence E. Hartwig

Lawrence E. Hartwig
Chairman

ADDITIONAL COPIES OF THE FORMS AND THIS BOOKLET

May be obtained in person or by communicating with:

The Renegotiation Board
1910 K Street, N.W.
Washington, D.C. 20446

Western Regional Renegotiation Board
300 N. Los Angeles Street
Los Angeles, California 90012

Or may be obtained in person at the following Department of Commerce Field Offices:

iquerque, N. Mex.	U.S. Courthouse	Jacksonville, Fla.	208 Laura St.
orage, Alaska	Loussac-Sogn Bldg.	Kansas City, Mo.	911 Walnut St.
nta Ga.	75 Forsyth St., N.W.	Los Angeles, Calif.	1031 S. Broadway
ltimore, Md.	U.S. Customhouse	Memphis, Tenn.	167 N. Main St.
rmingham, Ala.	908 S. 20th St.	Miami, Fla.	51 S. W. First Ave.
ston Mass.	Cambridge & New Sudbury Sts.	Milwaukee, Wis.	238 W. Wisconsin Ave.
ffalo N.Y.	117 Ellicott St.	Minneapolis, Minn.	110 S. Fourth St.
arleston, S.C.	334 Meeting St.	New Orleans, La.	610 South St.
arleston, W. Va.	500 Quarrier St.	New York, N.Y.	350 Fifth Ave.
eyenne, Wyo.	2120 Capitol Ave.	Philadelphia, Pa.	1015 Chestnut St.
icago, Ill.	219 S. Dearborn St.	Phoenix, Ariz.	230 N. First Ave.
ncinnati, Ohio	550 Main St.	Pittsburgh, Pa.	1000 Liberty Ave.
eveland, Ohio	E. 6th St. & Superior Ave.	Portland, Oreg.	520 S.W. Morrison St.
llas Tex.	1114 Commerce St.	Reno, Nev.	300 Booth St.
nver, Colo.	20th & Stout Sts.	Richmond, Va.	400 N. Eighth St.
s Moines, Iowa	509 Grand Ave.	St. Louis, Mo.	1520 Market St.
troit, Mich.	445 Federal Bldg.	Salt Lake City, Utah	125 S. State St.
eensboro, N.C.	U.S. Post Office Bldg.	San Francisco, Calif.	450 Golden Gate Ave.
rtford, Conn.	18 Asylum St.	Santurce, P.R.	605 Condado Ave.
nolulu, Hawaii	1022 Bethel St.	Savannah, Ga.	125-29 Bull St.
uston, Tex.	515 Rusk Ave.	Seattle, Wash.	909 First Ave.

INTRODUCTION

Scope of renegotiation: Renegotiation is the process of determining what part, if any, of the profits realized from defense contracts and subcontracts is excessive. Excessive profits are determined by the application of certain statutory factors; this is done by judgment, not formula. Contracts are not renegotiated individually. Renegotiation is conducted, rather, with respect to the receipts or accruals of the contractor under all his renegotiable contracts and subcontracts in his entire fiscal year.

The Renegotiation Act of 1951, as amended, relates only to prime contracts with the Departments of Defense, the Army, the Navy, and the Air Force, the Maritime Administration, the Federal Maritime Board, the General Services Administration, the National Aeronautics and Space Administration, the Atomic Energy Commission, and (since July 1, 1964) the Federal Aviation Agency, and to related subcontracts, including purchase orders. Certain types of contracts with these agencies and certain types of subcontracts are exempt, in whole or in part, from renegotiation (see page 5). Thus, it will be noted that a Government business is not within the scope of the Act.

Contractors whose renegotiable receipts or accruals in a fiscal year exceed the prescribed statutory minimum are required to file a Standard Form of Contractor's Report. To compile the report, the contractor must segregate his renegotiable from his non-renegotiable business and must also determine the costs and expenses allocable to each such segment. Generally, all amounts deductible for Federal income tax purposes are allowable as costs in renegotiation to the extent allocable to renegotiable business.

Contractors with renegotiable receipts or accruals below the prescribed statutory minimum need not file the Standard Form of Contractor's Report, but may, if they choose, file the Statement of Non-Applicability.

Renegotiable business: In the attached instructions, references are made to "renegotiable sales," "renegotiable business," and "renegotiable receipts or accruals." These terms are used interchangeably to refer to the amounts received or accrued by a contractor under all his renegotiable contracts and subcontracts in a fiscal year.

Contractor: As used herein, the term "contractor" includes subcontractor, except when the context indicates otherwise.

Fiscal year: This term, ordinarily, means the taxable year or taxable period of the contractor for Federal income tax purposes.

Renegotiation Board Regulations: The Renegotiation Board Regulations are cited as "RBR" followed by the part or section number.

Person: As used herein, the term "person" includes an individual, firm, association, partnership, and any organized group of persons whether or not incorporated, including joint ventures.

Common control: In determining whether a filing is required for a fiscal year, the renegotiable sales of a contractor are aggregated with those of all other persons under control of or controlling or under common control with such contractor. For further explanation, see page 7.

Consolidated renegotiation: Contractors under control of or controlling or under common control with other persons, and desiring to be renegotiated on a consolidated basis, should consult RBR Part 1464, with particular reference to the letter form of request to be submitted.

Letter of Preliminary Inquiry (LPI) number: This is the identification number given each contractor or subcontractor. The LPI number is shown below the address of the contractor on the back cover of this booklet. To facilitate the handling of filings, correspondence and telephone calls, reference should always be made to this number.

FILING REQUIREMENTS

Who must file: (a) A filing must be made by every contractor or subcontractor (other than subcontractors known as brokers or manufacturers' agents) having receipts or accruals which exceed $1 million in a fiscal year from contracts or subcontracts subject to the Act.

(b) A filing must be made by every broker or manufacturer's agent having receipts or accruals which exceed $25,000 in a fiscal year from subcontracts subject to the Act.

(c) In computing whether the applicable amount stated above is exceeded, the renegotiable business of parent, subsidiary and commonly controlled contractors must be aggregated (see Common Control, page 7).

(d) If the fiscal year of the contractor or subcontractor is less than 12 months, the applicable statutory minimum of $1 million or $25,000, as the case may be, is prorated accordingly. For example, if the fiscal year of a contractor (other than a broker or manufacturer's agent) covers a nine-month period, the "floor" is 9/12 of $1,000,000, or $750,000.

(e) The Act prescribes penalties for willful noncompliance.

Who may file: If renegotiable receipts or accruals computed as above for a fiscal year do not exceed the applicable statutory "floor", the contractor may file but is not required to do so. The choice is his. If a filing is made in good faith and the Board does not commence renegotiation within one year thereafter, the contractor achieves the advantage that his responsibilities under the Act have been fully discharged for the period covered by such filing.

What to file: (a) A single copy of the Standard Form of Contractor's Report, marked RB Form 1, must be filed by those contractors and subcontractors whose renegotiable receipts or accruals exceed the statutory minimum.

(b) A single copy of the Statement of Non-Applicability, marked RB Form 90, is to be used by those contractors and subcontractors having renegotiable receipts or accruals less than the statutory minimum, who elect to file.

Note: The appropriate form included in this booklet should be used.

Who may sign: The Standard Form of Contractor's Report and the Statement of Non-Applicability may be signed by an individual duly authorized to do so. Documentary evidence of such authority, such as a corporate resolution or a power of attorney, must be submitted unless the individual signing is a corporate officer, a partner or a joint venturer, or a sole proprietor.

When to file: The Standard Form of Contractor's Report must be filed on or before the first day of the fifth month following the close of the contractor's fiscal year. For example, if a contractor's fiscal year ends on December 31, the report must be filed on or before May 1 of the following year.

Extensions of time for filing will be granted for good cause upon written request of the contractor. Such requests should be made prior to the due date for the filing. When the time to file the Federal income tax return has been extended, the renegotiation filing need not be made until 15 days after the extended due date of the tax return, provided a copy of the document evidencing the extension of time is filed with the Board on or before the original due date for the renegotiation filing. If an additional extension of time is granted by the Internal Revenue Service, the filing need not be made until 15 days after the extended date set by Internal Revenue, provided a copy of the document evidencing such extension is filed with the Board on or before the last due date for the renegotiation filing.

The renegotiation filing should not be made prior to filing your Federal income tax return.

Where to file: Filings should be made with The Renegotiation Board, Washington, D.C. 20446.

Note: Please refer to your prior year's filing, if one was made. If the Board requested additional information concerning such filing in order to make it acceptable, be sure that like information applicable to your current filing is included.

INSTRUCTIONS FOR PREPARING THE STANDARD FORM OF CONTRACTOR'S REPORT

The following instructions are arranged to conform with the sequence of sections in the Standard Form of Contractor's Report (RB Form 1). If any space provided on RB Form 1 is inadequate, additional sheets similarly numbered and captioned should be used. The Form provided is to be considered as a guide and should be expanded to the degree necessary to portray your business adequately. Wherever supporting data are required, the Board will accept a photocopy of your work papers.

Enter your LPI number in the space provided on RB Form 1. Enter your taxable year in the space designated "fiscal year ended" in the heading of the report.

Contractors having renegotiable business, who wish to be considered as a group for renegotiation, may file on a consolidated basis for such group under certain conditions (see RBR Part 1464). The documents submitted should include: (1) the Standard Form of Contractor's Report prepared on a consolidated basis, with a consolidated balance sheet for this fiscal year (and for the preceding fiscal year unless previously furnished) and a consolidated income account; (2) separate complete RB Form 1 for each group member, with individual financial statements; (3) a consolidating income statement showing separately renegotiable and non-renegotiable business of each group member in the detail specified in Section 1 of RB Form 1; and (4) the appropriate letter form of request.

SECTION I

Income Statement for Renegotiation

If you are engaged in more than one type of renegotiable business, manufacturing products of widely diversified nature, or if you operate on a divisional basis, schedules showing operating results by principal products or divisions should be submitted to supplement the information requested.

Lines 1 - 6 should be completed by using book figures except that adjusted figures should be used to reflect changes made by special accounting agreements or contract price revisions.

SALES (NET): "Net" means less discounts, returns and allowances.

Line 1. a. Prime Contracts: Enter in appropriate columns renegotiable sales (net) under prime contracts or purchase orders with agencies named in the Act, the Departments of Defense, the Army, the Navy, the Air Force, the Maritime Administration, the Maritime Board, the General Services Administration, the National Aeronautics and Space Administration, the Atomic Energy Commission, and (since July 1, 1958) the Federal Aviation Agency.

Column (B) - Enter total sales under firm fixed-price contracts only. Do not include in this column sales under any contract containing price adjustment provisions of any kind.

Column (C) - Enter total billings and accruals, including fees, under cost-plus-a-fixed-fee (CPFF) contracts. Do not include in this column sales under cost-plus-incentive-fee (CPIF) contracts.

Column (D) - Enter total sales under all other types of contracts, including fixed-price incentive (FPI) and cost-plus-incentive-fee (CPIF) contracts. Sales under CPIF contracts are billings and accruals, including fees. If multiple incentives are involved, attach a statement describing the incentive provisions in the CPIF contracts and the method of recording accruals. Also include in this column sales under contracts providing for escalation, redetermination or other price revision, time and material contracts, facilities contracts, termination settlements, etc.

If sales under more than one type of contract are included, furnish a supplemental schedule showing sales of each type with related costs and expenses. If the sales include significant amounts of price adjustments, state such amounts by contract types and the portions applicable to this fiscal year and any prior year.

Line 1. b. Subcontracts: Enter in appropriate columns renegotiable sales (net) under subcontracts, including purchase orders, etc. The instructions for prime contracts apply also to the subcontract sales shown on this line.

Line 1. c. Commissions: Enter in Column (D) total renegotiable receipts or accruals under subcontracts of the type commonly held by brokers or manufacturers' agents. Such amounts include not only compensation based upon a percentage of the principal's sales, but also fees, retainers, etc. See page 8, Special Instructions for Brokers and Manufacturers' Agents.

Line 1. d. Royalties, Rentals, Management Fees, etc.: Enter in Column (D) total renegotiable receipts or accruals of the types specified on this line. Classify amounts included by types, attaching statement if necessary.

Line 1. e. Total Net Sales: In Column (A), enter the sum of Columns (B), (C), (D) and (E). If total net sales entered in Column (A) are not in agreement with the total sales shown in your income statement or audit report, furnish a reconciliation of such difference on an attached schedule.

Line 2. COST OF GOODS SOLD:

Lines 2. a. - 2. e.: Enter in the appropriate columns the amounts of the components comprising the Cost of Goods Sold.

un costs are used and the components of Cost of s Sd are not available, furnish an approximation ch omponent, expressed in either dollars or per- ges Attach an explanation of the disposition of ior variances, if any, and the effect thereof on iple and non-renegotiable Cost of Goods Sold .).

he mounts recorded for the various types of con- sould be the costs and expenses actually paid or re under such contracts and allocated in accord- wi your system of accounts, rather than the ts of costs and expenses allowed or accepted r sh contracts by the customer.

p c l rules for the allocation of research and pment expenses are set forth in RBR 1459.8(e). ral, such expenses are allocable to renegotiable ss to the extent that they are required for, or nt to the performance of, any renegotiable con- Cher research and development expenses may a cated if incurred in basic research expected nc the company as a whole or if incurred as a ca on to bid or negotiate for future defense busi- oro perform such business more efficiently.

SE LING & ADVERTISING EXPENSE:

3a. - 3. g.: Selling expense generally is allo- e to renegotiable business only to the extent that t lates in major part to services performed in n and adapting renegotiable products to the uses req rements of the customer; or (2) it relates to nai enance of offices engaged in servicing rene- b roducts; or (3) it relates to the sale of rene- le roducts or services which are of a type ordi- y sld or rendered by the contractor through his al stem of distribution; or (4) it is a commission or payable to non-employees such as brokers, fac rers' agents, etc. (see RBR 1459.7(a)).

commissions allocable to renegotiable business d 5,000 for any agent, submit a schedule showing m and address of each such agent and the amount re to renegotiable business.

a tising expense generally is not allocable to n tble business except for expenditures pertaining p anted, disposal of scrap or surplus materials, ne rocurement of scarce items. Advertising ex- ay be allocated to subcontract business if the ct sold are substantially similar to those sold in b ntractor's normal commercial business. Costs b hing catalogues, technical pamphlets, house s nd similar publications are allocable to rene- le usiness. (RBR 1459.7(b) and (c) and 1459.8(f)).

GI ERAL & ADMINISTRATIVE EXPENSE:

4a. - 4. d.: Enter on appropriate lines only those n which are classified as general and administra- nse under your system of accounts.

Enter any costs or expenses not included in 2 4 under your system of accounts.

Line 7. ADJUSTMENT TO TAX BASIS:

Attach schedule detailing adjustments to Federal income tax basis of figures used in Lines 1 - 6 showing the allocation of each adjustment between renegotiable and non-renegotiable business. Explain the method used in allocating such adjustments. In the case of corporations, these adjustments are usually the "Schedule M" type, relating to such items as insurance premiums on the lives of corporate officers, depreciation, research and development expense, etc.

Line 8. TOTAL COSTS & EXPENSES:

Enter the total costs and expenses reported on Lines 2 - 6 as adjusted on Line 7.

Line 9. OPERATING PROFIT OR (LOSS):

Enter the difference between Line 1. e. and Line 8.

Line 10. OTHER INCOME & (DEDUCTIONS) *NET*, ALLOCABLE IN WHOLE OR PART TO RENEGOTIABLE BUSINESS:

Enter in Column (A) amount representing the difference between non-operating income and deductions, such as interest income, interest expense, etc., and allocate this amount to other columns as appropriate. Attach schedule detailing these items in the amounts shown in your Federal income tax return, and explain method used for allocation.

Line 11. NET PROFIT FOR RENEGOTIATION BEFORE STATE INCOME TAXES:

Enter the difference between Line 9 and Line 10. If the profit margin varies significantly between renegotiable and non-renegotiable business under the same type of contract, explain the reasons for such variation. In the event of losses, explain the reasons as they relate to Columns (B), (C), and (D).

Line 12. OTHER INCOME & (DEDUCTIONS) *NET*, ALLOCABLE WHOLLY TO NON-RENEGOTIABLE BUSINESS:

Enter amount representing the difference between non-operating income and deductions, such as profit or loss on sale of capital assets, dividends, etc., which are allocable wholly to non-renegotiable business. Attach schedule detailing these items in the amounts shown in your Federal income tax return.

Line 13. STATE TAXES MEASURED BY INCOME:

Enter the amount of state taxes measured by income, if applicable.

Line 14. NET INCOME PER TAX RETURN:

Enter amount shown on Line 11, plus or minus Line 12, minus Line 13. In the case of a corporation, this amount ordinarily will be that shown in the Federal income tax return before net operating loss deduction and special

on. If the amount differs from "Net Income Per eturn" because of price adjustments or a special in agreement, attach reconciling schedule and ex-

. PECIAL ITEMS IN LINES 2 - 7:

1. a. Research & Development Expense: Enter esearch and development expense included in s - 7.

1. b. Total Officers' Compensation: Enter total cer' compensation included in Lines 2 - 7. This amount should include salaries, bonuses, profit sharing, etc.

Line 15. c. Approximate Subcontracting: Enter the approximate amount of subcontracting included in Cost of Goods Sold and attach a brief statement of the nature of the work subcontracted. This information is needed to evaluate the character of your business. Generally, for this purpose, subcontracting includes the purchase of major assemblies, subassemblies, components, services, etc., as distinguished from the purchase of raw materials, bars, sheets, etc.

SECTION II

Segregation of Sales and Allocation of Costs and Expenses

(a) Segregation of Sales (See RBR Part 1456)

cri e the method used in effecting your segregation o ible and non-renegotiable sales, including par- ly e method of determining exempt sales and the s ereof. A mere statement that sales have been te in accordance with the Act or the regulations suf ciently descriptive and may result in rejection tandard Form of Contractor's Report.

ss exempt, all amounts received or accrued under co racts with the agencies named in the Act are t renegotiation. These agencies are the Depart- of efense, the Army, the Navy, and the Air Force, iti e Administration, the Federal Maritime Board, r Services Administration, the National Aeronau- ce Administration, the Atomic Energy Commis- since July 1, 1964) the Federal Aviation Agency. am nts received or accrued under related sub- ts re also subject to renegotiation. The term ra" includes any purchase order or agreement k o materials required for the performance of a re- le rime contract or higher-tier subcontract, in- wo done for affiliated or related companies. The iab business of subcontractors known as brokers fac rers' agents is derived generally from fees or sio for attempting to obtain or obtaining renego- in contracts or subcontracts (see page 8, Special on for Brokers and Manufacturers' Agents).

ntracts subject to the Act may be identified by o customers; by the presence of a clause which hat he contract is renegotiable; by the presence of nc to a Government contract number; or by the e a reference to a priority number or symbol e of the named agencies.

th duty of subcontractors to request segregation o from their customers as needed, and it is the cu omers to supply it. The subcontractor is re- to ake inquiries of customers whose use of the s ld by the subcontractor is not known, but whose th subcontractor has reason to believe may be r negotiation. When the subcontractor's customers r s, he may employ a sampling technique. In s he will find that his customer's renegotiable ffords a convenient indication of the extent to s les to such customer are subject to renegotia- tion, without attempting to identify the individual sales one by one. For example, a subcontractor who delivers castings to a prime contractor manufacturing aircraft engines may ascertain upon inquiry that, of all that manufacturer's engines sold during the year, incorporating these castings, 70 percent were delivered to fulfill military orders and 30 percent were delivered to the civilian market. This subcontractor would be justified in assuming, for purposes of renegotiation, that 70 percent of his sales of castings to such prime contractor in such year were renegotiable, assuming, of course, that none of the exemptions hereinafter mentioned was applicable. No inquiry need be made of any customer with whom the subcontractor did business aggregating less than $2500 during the fiscal year. This does not mean that such sales of less than $2500 are exempt. They should be segregated between renegotiable and non-renegotiable business on a reasonable basis.

Among the exemptions in the Act are those relating to:

(1) Prime contracts and subcontracts for standard commercial articles or services, like articles or services, and standard commercial classes of articles (Instruction, Section VI; RBR 1467, Subpart (B)).

(2) Prime contracts and subcontracts for new durable productive equipment (partial mandatory exemption) (RBR Part 1454).

(3) Construction prime contracts awarded in conformity with the requirements for procurement by formal advertising set forth in section 3 of the Armed Services Procurement Act of 1947 (10 U.S.C. 2305).
Note: No supplements or modifications are exempt if the aggregate price of all such changes exceeds one-third of the original contract price. See RBR 1453.7.

(4) Prime contracts, including purchase orders, where the aggregate amount involved does not exceed $1000 and the period of performance does not exceed 30 days (RBR 1455.3(b)(5)).

The Board will not disapprove any method used in developing the amount of your renegotiable business if it is satisfied that such method, in the circumstances, affords the best basis for a reasonably precise determination. Therefore, the foregoing instructions are offered for assistance only; any other method may be used if the circumstances warrant.

(1) Allocation of Costs and Expenses
(See RBR Part 1459)

Attach a description of your cost accounting system and the methods used in allocating to renegotiable business cost of goods sold, selling and advertising expense, general and administrative expense, adjustment to tax basis, and other income and deductions. The description of your cost accounting system should include: a statement whether such system is under general ledger control; an explanation of any significant changes made during the year in allocating costs and expenses; and a statement whether the system is job order, process, standard cost, etc.

SECTION III

Financial Statements

company practice; cost of goods sold, with details of manufacturing cost, including factory burden; selling and administrative expenses; and miscellaneous items.

The balance sheet should show, in addition to the usual classifications, the gross plant account and related reserve for depreciation, and other major reserves separately stated, with their purposes clearly described.

SECTION IV

Method of Accounting Employed

from that used for tax purposes, and you have not received permission from the Board to use such method, prepare this report on your tax basis, explain the effect of the proposed method, and request permission to make such change. (RBR 1459.1 (b))

SECTION V

Voluntary Refunds and Voluntary Price Reductions

required by the terms of your contracts or subcontracts. Do not include refunds or price reductions made pursuant to price adjustment provisions in your contracts.

SECTION VI

Exemption of Commercial Articles or Services
(See RBR Part 1467, Subpart B)

(b) Application to Board: Paragraph (b) relates to amounts received or accrued under contracts or subcontracts for any of the following:

1. An article which is identical in every material respect with a standard commercial article--i.e., a "like article" (RBR 1467.26).
2. An article in a standard commercial class of articles (RBR 1467.27).
3. A standard commercial service (RBR 1467.28 and 1467.29).

rvice which is reasonably comparable with a
ard commercial service--i.e., a "like service"
1467.30).

ese four categories are not exempt unless you
plication for Commercial Exemption with the
uch exemption is granted. For specific instruc-
rning the form and filing of an Application for
Exemption, see RBR 1467.31. If you file an
for Commercial Exemption, do not file the Stand-
ard Form of Contractor's Report until the Board has acted upon such application.

(c) Waiver of Exemption: Any contractor or subcontractor may waive this exemption, in whole or in part (RBR 1467.23). Paragraph (c) of Sec. VI provides for such waiver.

Note: This exemption does not apply to brokers or manufacturers' agents.

SECTION VII

Organizational Changes

n explanation of any organizational changes
scal year, such as reorganization; acquisition, disposal or dissolution of subsidiaries; sale of controlling stock; conversion of a partnership to corporate form, etc.

SECTION VIII

Common Control

ng the floor provisions of the Act to determine
are required to file the Standard Form of Con-
Report for your fiscal year, your renegotiable sales
r must be aggregated with those of all other
rolled by you, or who are under your control
common control with you. Thus, in applying the
and subsidiary corporations are considered
well as all related persons.

, for the purposes of the Act, control may exist
the ownership of more than 50 percent of the
of a corporation, or the right to more than 50
e profits of a partnership or joint venture for
ar under review. Such control may reside in
or in a group of individuals who customarily
or who by reason of their family relationship
ected to do so. In other cases, control may
even though the persons having such control
a 50 percent interest.

In all cases, whenever any possibility of control exists, the facts should be fully disclosed to the Board. If two or more contractors or subcontractors are controlled by members of the same family group or groups, a full disclosure of such family relationships must be made.

The following example shows how the common control provision of the Act operates: Corporations A, B and C are controlled, through stock ownership, by an individual D; in a given fiscal year, after eliminating receipts or accruals from intercompany transactions, A has $100,000 of renegotiable sales, B has $875,000, and C has $50,000. Each corporation is required to file the Standard Form of Contractor's Report because the total renegotiable sales of all three exceed $1 million. In addition, if the individual D has any renegotiable business, he would also have to make such a filing.

SECTION IX

Products Sold or Services Rendered

ll more than one product or render more
rvice, furnish the information requested for each principal product or service.

SPECIAL INSTRUCTIONS FOR BROKERS AND MANUFACTURERS' AGENTS
(See RBR Part 1490)

sand manufacturers' agents who have renego-
cots or accruals are subcontractors under
03(g)(3) of the Act. The subcontracts described
con are arrangements for the payment of com-
b a contractor to any person other than a bona
ide officer, partner or full-time employee, under

a) an amount payable is contingent upon the pro-
er of a renegotiable contract or subcontract; or
b) an amount payable is determined with reference
e amount of a renegotiable contract or subcontract;

c) all part of the services performed or to be per-
d consists of the soliciting, attempting to procure,
ing a renegotiable contract or subcontract.

a broker or manufacturer's agent, you should
the Instructions for Preparing the Standard Form of Contractor's Report, except that Lines 1. a., 1. b., and 1. d., Lines 2. a. - 2. e., and Line 15. a. and 15. c. of Sec. I, and Sec. V and VI do not apply and should not be completed. To secure the basic information you need regarding your renegotiable commissions, you will generally find it helpful to consult your principals.

Important:

In addition to other information requested, attach a statement showing for this fiscal year:

(a) Sales volume (referable sales), renegotiable and non-renegotiable, on which your commissions were based, showing separately renegotiable sales and commissions by major principals.

(b) Your compensation arrangement (commission rates, retainer fees, etc.) with each major principal. If the arrangement for renegotiable business differs from that for non-renegotiable business, explain.

INSTRUCTIONS FOR PREPARING THE STATEMENT OF NON-APPLICABILITY

report form is for the use of contractors whose
able receipts or accruals aggregate less than the
ed minimum amount. For contractors and subcon-
ctor than brokers and manufacturers' agents,
mn is $1,000,000; for brokers, manufacturers'
others holding subcontracts of any of the types
Section 103(g)(3) of the Act, the minimum is

not required to file this report but may elect to
hould you so elect, all information called for in the
st be furnished. If such report is filed and the Board
commence renegotiation within one year thereafter,
sponsibilities under the Act will be fully discharged
eriod covered by such filing.

orm should not be used by any contractor who is a
of a commonly controlled group having an aggre-
ore than $1,000,000 or $25,000, as the case may be,
table receipts or accruals, after eliminating inter-
ansactions; in such a case, the Standard Form
ctor's Report must be filed.

structions that follow conform with the sequence of
ems in the Statement of Non-Applicability (RB Form

graph 1. In the first blank space fill in the amount
00 000 unless your fiscal year is less than twelve
nths, in which event prorate this amount. For
mple if your Federal income tax return covered a
nth period, you would insert $750,000.
the second blank space enter the amount of your
ent renegotiable receipts or accruals. This figure
t include any amount shown in paragraph 7(b),
mount of any other exempt contract or subcon-
or assistance in computing such receipts or
al see page 5.

graph 2. Enter the amount of your nonexempt rene-
ble commissions, etc., in the appropriate space. Such amount includes not only compensation based upon a percentage of the principal's sales, but also fees, retainers, etc.

Paragraph 3. If you expect to receive or accrue any further renegotiable amounts attributable to this fiscal year, such amounts must be included in computing total renegotiable receipts or accruals for this fiscal year.

Paragraph 4. List name and address (city and state only) and check appropriate box for each person, firm or corporation under control of, controlling, or under common control with you during this fiscal year. If additional space is needed, continue on the reverse side of the form. See page 7, Common Control.

Paragraph 5. Check appropriate boxes to indicate the method of accounting employed in filing your Federal income tax return and in preparing this report. See page 6, Method of Accounting Employed.

Paragraph 6. Enter the amount of gross receipts or gross sales, less returns and allowances, shown in your Federal income tax return.

Paragraph 7. This paragraph relates to amounts received or accrued under any contract or subcontract for a "standard commercial article" (see RBR 1467.24 and 1467.25). You are entitled to apply this exemption, without application to the Board, only with respect to articles which meet the special definition contained in the Act. It is therefore important that you consult the regulations before entering any amount in this paragraph.

Paragraph 8. Attach a full description of the method used by you in segregating sales between renegotiable and non-renegotiable (Instructions, Section II (a)).

fled with

TH
A ON BOARD
on D.C. 20446

before 1st
th alendar
ving close
isil year

FOR RENEGOTIATION

Budget Bureau
No. 101-R002

CONTRACTOR'S NAME	ENTER LPI NO.
NUMBER AND STREET	
CITY AND STATE ZIP CODE	
FISCAL YEAR ENDED _____, 19 ____	

Income Statement for Renegotiation

CLASSIFICATION	TOTAL (A)	RENEGOTIABLE			NON-RENEGOTIAB (E)
		FIRM FIXED PRICE (B)	CPFF (C)	OTHER (D)	
ii): Cdrocts		$	$	$	
Ir ts					
ssns					
e Rentcls, Mgmt. Fees, etc.					
Tcl Net Soles	$				$
CODS SOLD: ds					
Lior					
rt lg. Exp. *(Attach Schedule)*					
Tcl Cost of Goods Sold					
G & DVERTISING EXPENSE: es					
ssns					
O ce Expense					
elng Expense *(Attach Schedule)*					
ol Selling Expense					
si Expense					
To Selling & Advertising Expense					
L & DMINISTRATIVE EXPENSE: ss'alories					
Offe Solories'					
Atch Schedule)					
To Gen'l. & Adm. Expense					
MEOKS TO TAX BASIS *(Att. Sched.)*					
OSS & EXPENSES					
K (PROFIT OR (LOSS)					
NCAE & (DEDUCTIONS) *NET*, L IN WHOLE OR PART TO RE- SE BUSINESS *(Attach Schedule)*					
OFI FOR RENEGOTIATION SITE INCOME TAXES					
NCAE & (DEDUCTIONS) *NET*, L WHOLLY TO NON-RENEGO- UNESS *(Attach Schedule)*					
AXS MEASURED BY INCOME					
M PER TAX RETURN					
TMS IN LINES 2-7: sh Development Expense					
ffi rs' Compensation					
S contracting in Line 2e. Above					

Segregation of Sales and Allocation of Costs and Expenses (Instruction II)

W ATTACH A FULL DESCRIPTION OF THE METHODS USED IN:

(a Segregating sales between renegotiable and non-renegotiable, including the method of determining exempt sales and the amounts thereof by type.

(b Allocating cost of goods sold and expenses between renegotiable and non-renegotiable business.

(b) Statement of surplus for this fiscal year.

(c) Balance sheet as of the close of this fiscal year.

IV. Method of Accounting Employed:

	Cash	Accrual	Completed Contract
Federal income tax return	☐	☐	☐
This report	☐	☐	☐

Our taxable year and the period covered by this report are: The same ☐ different ☐ (If different, attach explanation.)

V. We made ☐ made no ☐ voluntary refunds and voluntary price reductions applicable to renegotiable contr subcontracts in this fiscal year. If applicable, complete the following: Total voluntary refunds $ _____ Total voluntary price reductions $ _____

VI. Exemption of Commercial Articles or Services:

(a) *Answer ONLY if you have self-applied the exemption (Instructions, VI (a)):*
We have self-applied the exemption in the amount of $ _____ and have excluded such renegotiable sales in Section I of this report.

(b) *Answer ONLY if you have applied to the Board and received an exemption for this fiscal year (Instruct*
The Board has granted our application for exemption in the amount of $_____ and we cluded such amount from renegotiable sales in Section I of this report. We have not excluded any amoun which exemption was denied.

(c) *Check ONLY if you desire to waive the exemption in whole or in part (Instructions, VI (c)):*
Except for any amounts shown in (a) or (b) above, the exemption is hereby waived ☐.

VII. There were ☐ were no ☐ changes in the form or control of our organization during this fiscal year. (If th any changes, attach explanation.)

VIII. There were ☐ were no ☐ persons under control of, or controlling, or under common control with us durin fiscal year. (If there were, attach statement showing name and address of each such contractor, with a brie tion of the character of its business and the nature and extent of its relationship with you, and indicating w had renegotiable business.) (Instruction VIII)

IX. Principal products sold or services rendered during this fiscal year	Estimated Amounts		State whether manufa assembling, distribut
	Renegotiable	Non-Renegotiable	
	$	$	

Certification

The undersigned certifies, under the criminal penalties provided in Sec. 105(e)(1) of the Renegotiation Act of 19 thorized to sign this report on behalf of the contractor and that the representations contained in this report are tru to the best of his knowledge and belief.

If a corporation:

_____
State of incorporation

_____
Date of incorporation

_____
Exact name of contractor (not abbreviated)

If a partnership or proprietorship:

_____
Date business established

_____
Signature of officer, partner or proprietor

_____
Date of this report

REFORM 90

EGOTIATION BOARD,
NGTON, D.C.20446

STATEMENT OF NON-APPLICABILITY OF THE RENEGOTIATION ACT OF 1951, AS AMENDED

Form Approved
Budget Bureau
No. 101-R002

ENTER LPI NO.

a beginning _____ 19___, and ended _____ 19___.

ractors other than brokers and manufacturers' agents). Our nonexempt receipts or accruals (together with those persons* named in paragraph 4 below) under contracts or subcontracts subject to the act, did not exceed _____ for this fiscal year *(Insert $1,000,000 unless fiscal year is less than 12 months, in which prate such amount).* Our own nonexempt renegotiable receipts or accruals in this fiscal year aggregated _____.

ers and manufacturers' agents). Our nonexempt commissions and other receipts or accruals (together with those ons* named in paragraph 4 below) under subcontracts described in Section 103(g)(3) of the Act, did not $5,000, or the prorated portion thereof, for this fiscal year. Our own nonexempt receipts or accruals from such cts aggregated $_____.

nc expect to receive or accrue any further amounts applicable to this fiscal year which would bring aggregate ble receipts or accruals above the $1,000,000 floor or the $25,000 floor, or the prorated amount thereof.

lowing persons* and no others, controlled or were under control of or under common control with us during this e: *(If none, write "none"; do not insert your own name):*

NAME	CITY AND STATE	RENEGOTIABLE BUSINESS YES	RENEGOTIABLE BUSINESS NO
		☐	☐
		☐	☐
		☐	☐

accounting employed:

	Cash	Accrual	Completed Contract
del income tax return	☐	☐	☐
is report	☐	☐	☐

sales or gross receipts (less returns and allowances) reported for Federal income tax purposes _____.

ther: *(a)* The standard commercial article exemption has not been self-applied by us ☐

or

(b) The standard commercial article exemption has been self-applied by us to otherwise renegotiable sales in the amount of $_____.

ch full description of the methods used in segregating sales between renegotiable and non-renegotiable.

erm "person" includes an individual, firm, association, partnership, and any organized group of persons whether or not orporated, including joint ventures.

Certification

ndersigned certifies, under the criminal penalties provided in Sec. 105(e)(1) of the Renegotiation Act of 1951, s authorized to sign this report on behalf of the contractor and that the representations contained in this report ar correct to the best of his knowledge and belief.

ortion:

_____ incorporation _____ Date incorporated

_____ ship or proprietorship:

_____ Date business established

_____
Exact name of contractor (not abbreviated)

_____
Mailing address (including Zip code)

_____ _____
Signature of officer, partner or proprietor — Title

_____
Date of this report

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