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RENEGOTIATION AND PROFIT CONTROL

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13 January 1953

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Honorable John T. Koehler, Chairman, the Renegotiation Board, was born in Pennsylvania in 1904. He attended Grove City College, Pennsylvania, the University of Pittsburgh, and Princeton University. He received a B.A. degree with highest honors from Princeton in 1926 and was a Phi Beta Kappa. In 1930 he received his LL.B. from Harvard and began the practice of law in New York City and Pittsburgh. In 1933 he became an attorney for the Bureau of Internal Revenue and in 1934-1935 was transferred to the Department of Justice as a special assistant to the Attorney General. He returned to private practice in Baltimore, Maryland, until 1942 when in January he joined the legal staff of the Navy Department. From November 1942 until November 1945 he served in the Navy as a lieutenant commander and commander. Early in 1946 he joined the Office of the General Counsel for the Navy Department, in August was made counsel for the Bureau of Ships, and in May 1947 was appointed assistant general counsel for the Navy Department. He succeeded Mr. Mark Andrews as the Assistant Secretary of the Navy in February 1949. In May 1950 when the Maritime Commission was abolished, President Truman designated Mr. Koehler the acting chairman of the new Federal Maritime Board as well as its administrator. Mr. Koehler resigned as Assistant Secretary of the Navy on 3 October 1951 and was appointed by the President as a member of the Renegotiation Board. Upon being sworn in he was designated by President Truman as chairman of the Board on that same day. Mr. Koehler is licensed to practice law before the Supreme Court of the United States as well as in Pennsylvania and Maryland and before various Federal Courts and the Bar of the District of Columbia.

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RENEGOTIATION AND PROFIT CONTROL

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ADMIRAL HAGUE: The subject of our lecture this morning is "Renegotiation and Profit Control." Our guest is Mr. J. T. Koehler, Chairman of the Renegotiation Board, former Assistant Secretary of the Navy, and blue water sailor extraordinary.

I took advantage of my position as Commandant to insist upon introducing Mr. Koehler, not only because of his high position in the Government but because I thought that I personally was in the best position in the Industrial College to give you some information about him that does not appear in the written biography which has been issued to you.

Although he is not at all like Captain Thompson of the brig Pilgrim, on which the young Harvard student Richard Dana shipped as a foremast hand in 1834 for a long voyage to California and returned by Cape Horn, one of the speeches reported by Dana of Captain Thompson has always been brought to my mind by Mr. Koehler. They were leaving Boston and the captain called all hands aft for a get-together speech to lay down the laws of the Medes and Persians. Captain Thompson said, "I have been through the mill, ground, and bolted, and have come out a regular-built, Down-East Johnnycake.

Now in all my dealings with Mr. Koehler he reminds me of this "I have been through the mill, ground, and bolted."

In the biography that we received at the college from Mr. Koehler's officer, there was a factual statement of his legal background, both experience and attainments, in civil life, in Government circles, and in the Navy. Sandwiched down in the middle was a laconic statement "from November 1942 to November 1945 he served as a lieutenant commander and a commander in the Navy." Never was so much hidden by one man in so few words.

This service as a lieutenant commander and a commander of the Navy was not, as you might suspect, as a young and energetic lawyer in the maelstrom that was wartime Washington, but was very active service indeed on the active front.

He was a beachmaster at the invasion of Sicily, and, having learned by personal experience the problems of landing troops and supplies across a hostile beach, he devised a new sport. It was a sport in which young and lusty soldiers got together, tied rubber flappers on their feet, and went down into the ocean to search out a queer form of

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shellfish that had been planted by the Japanese, the mines which they fondly hoped would blow up any invasion force regardless of the condition of the defenders as a result of bombardment, bombing, and strafing. In short, he was the leader of the Navy's first underwater demolition team.

At the end of the war he returned to Washington and at last the Navy Department again got its clutches on his legal talents and he was plunged into the very difficult and complex situation of contract terminations, contract revision, contract negotiation, and renegotiation. I know that he did a good job, a splendid job, not only from what my contemporaries who were responsible for that work told me, but it happens in these days of technological progress, of which we in the college are so well aware, that we now have machines that unerringly gage such performance.

It happens that at the outbreak of hostilities in Korea, the Bureau of Ships of the Navy found it was desperately in need of a contract lawyer, and not any old lawyer would do. Now this IBM machine punches the cards which are fed into the hopper and grinds them about. When it is finished one card came out, Captain John T. Koehler, USNR. I understand that the IBM company has been asked by the Navy Department to add a device to this machine whereby when a Reserve officer happens to be in the secretarial position, bells will ring, buzzers sound, sirens shriek, and so on.

It was no surprise to us who knew him that in the constitution of the Renegotiation Board Mr. Koehler was snatched away from the Navy by the President and was named as the Board's first chairman. I had the honor of being present when he was sworn in. It may be worthwhile to repeat what I told him on that occasion. When I stepped up to greet him, I said, "I can only say if I were a manufacturer with a lot of secret profits I wanted to hide, I would hate to be renegotiated by you, Mr. Secretary."

I hope you know, sir, what a personal pleasure it is to me to welcome you to this platform.

MR. KOEHLER: Thank you very much, Wes.

Gentlemen, I am overwhelmed by that introduction but before I get into my subject, I will say frankly I would rather stand here and chew the fat about what happened to all of us in World War II, including the amusing things. I do want to tell you one story which is a story of my own experience and which involved the late great General Patton.

I was a beachmaster at Gela and we had an outfit of about 250 men--cooks, yeomen, storekeepers, and so forth. To my knowledge not one of them, including myself, had ever fired a rifle until we were going overseas and I got permission for every man to fire one round of ammunition from the fantail of the ship. That was the extent of our basic training in arms.

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But things were hot in Gela and in the middle of the first day we were on the beach helping unload cargo. I knew less about war than any enlisted man in the Army, I can tell you that. We couldn't get an LST in on account of an offshore sand bar. Suddenly, out of the town of Gela (which set up on a little cliff about 100 yards from the water) comes this command car and out stepped General Patton--the first and only time in my life I ever saw him.

He said, "Who is in command here?" I said, "I am, General." He said, "Get your officers and men and get up there in the hills to the left. The Germans have cut us off to the right. They are up in the hills to the left. Get your officers and men and get up in those hills." I said, to myself, of course, "This is the second front and they are calling on a gang like us."

Frankly, I didn't know what to do, so I distributed ammunition. I read once you should do that. I had my trusty 45 and I certainly couldn't hit the side of a house with it, then or now. We started up the hill feeling very foolish, like kids playing cops and robbers. I saw a couple of Army boys coming down the hill. They said, "Oh, no, we are not going up again. We are going back to the beach." I thought, "Here's the Navy to the rescue."

We went on up the hill. Nothing happened. Finally I saw two First Division enlisted men. They had a bazooka. I said, "Sons, what is going on up the hill?" They said, "Nothing's going on up the hill, Commander." I said, "How about going with us?" So they went with us. About three-fourths of the way up the hill we came to one little pillbox with a machine gun firing. One of the enlisted men said, "Get in back of me. I'll take care of this." He set up the bazooka and fired. It was over in a second. I said, "Okay, boys, we will go back to the beach." That was the first actual combat of the Navy on land in World War II, I am sure.

Now I suppose I will have to get to this subject of renegotiation lest I be charged with coming here under false pretenses. The subject is a very interesting one. It is very broad and all-encompassing. Profit control or attempts at profit control obviously have existed for as long as there have been contracts. It was true in George Washington's time, and no completely effective means of profit control ever have been devised or, in my opinion, ever will be devised.

We are making steps in the right direction and we are getting further and further along. But you cannot possibly devise a system that will guarantee that every manufacturer will come out with a reasonable profit on every procurement because obviously companies are different, situations are different, and economic conditions are different.

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Renegotiation is peddled to the public as a very mysterious affair. Actually, it is very simple. It is judgment and judgment if improperly controlled is one of the most dangerous things with which we are faced.

In World War I, as you well know, you had the device of procurement on the basis of cost-plus-a-percentage-of-cost. That was utterly stupid and we have grown up and beyond that; it is now forbidden. Between World War I and World War II there were 170-odd different bills introduced in Congress to provide for profit control or to provide measures whereby there would never again be so-called war profiteers.

In World War II renegotiation came about by expediency. Congress finally passed a law in 1943 and the statute in effect says that all companies engaged in defense work shall be renegotiated on the receipts and accruals from their defense business on a fiscal year basis. Renegotiation is tied to the Internal Revenue Code as by an umbilical cord.

The manner in which the act operates is this, and I think it is easier to take a simple illustration. General Motors has defense business which amounts to 3 billion dollars. That is a lot of money. G.M. is in greatly different kinds of procurement, from jet engines to trucks. General Motors, therefore, is subject to renegotiation on the defense business it completes during each fiscal year. Let us suppose it is on a calendar year basis so all of its receipts and accruals through 31 December 1951 are renegotiable.

First of all, when General Motors prepares its returns for us, it segregates its renegotiable from its nonrenegotiable business--that is important--and on that basis it must necessarily allocate to its renegotiable business a portion of plant and other overhead. That is the accounting area. Our people finally come to agreement with the General Motors accountants so that we in effect have what the lawyer would say is a stipulated set of facts.

We are charged by law with examining General Motors' renegotiable business in order to be sure that it made no more than a reasonable profit on the business which has been done for the calendar year 1951.

Now what are the things which must be taken into consideration? This is the heart of the statute. First, the statute says that we must eliminate excessive profits from General Motors business for 1951. But in determining excessive profits, the Congress has said things that are very broad in their context. I just want to give you an understanding of what a tough job this is if it is done in an honest, reasonable, and informed way.

The term "excessive profits" means the portion of the contracts derived from contracts with the Departments which is determined to be excessive. That is saying excessive is excessive.

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Now in determining excessive profits, favorable recognition must be given to the efficiency of the contractor and subcontractor.

1. "Must"--that is number one.
2. Efficiency with particular regard to attainment of quantity and quality production.
3. Reduction of costs and economy in the use of materials, facilities, and manpower.

In addition, there shall be taken into consideration the following factors:

1. Reasonableness of costs, with particular regard to volume of production.
2. Normal earnings and comparison of war and peacetime products.
3. The net worth, with particular regard to the amount and source of public and private capital employed.
4. Extent of risk assumed, including the risk incident to reasonable pricing policies.
5. Nature and extent of contribution to the defense effort, including inventive and developmental contribution and cooperation with the Government and other contractors in supplying technical assistance.
6. Character and extent of subcontracting and rate of turnover.
7. Such other factors as we might wish to add to this list.

Now I could say to you very frankly that it is impossible to do the job which Congress has assigned to the Renegotiation Board, and I would come close to being correct. But it is not impossible to do a thoroughgoing job along the lines that Congress intended and that is all we can do. Obviously, it is difficult for an agency such as mine, whose budget for the last year was a little over 5 million dollars, to attempt to decide whether or not General Motors is doing a more efficient job in its jet engine work in the Allison Division than Westinghouse is doing or that G. E. is doing.

I have the dubious distinction of being the only member of the Renegotiation Board to whom objection was made on the floor of the Senate when my name came up for confirmation, and the objection, strangely enough, was that I was not qualified to be on this board because of the years I had spent being intimately connected with the procurement policies of the Navy. Therefore, I, as former Assistant

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Secretary of the Navy, would, as a member of the Renegotiation Board, see to it that all contractors who had done business with the Navy came off a lot better than contractors who had done business with other services. I was not disturbed by that at all. But I think that my background in procurement was most essential to permit me to do an intelligent job in this field.

Now what is, if anything, the obligation on others outside the Renegotiation Board for the performance of its job? There can be no doubt that such an obligation exists. Renegotiation is a job that must be done and I have said the same thing to businessmen time and time again in my usual diplomatic and tactful way.

After World War II, this country did not have one single investigation similar to the scores there were between World Wars I and II on the question of war profiteers, munitions makers, and so forth. Why? There were many reasons. Procurement was better, sure, but you did have renegotiation and the companies went through the mill and they gave back a total of 11.5 billion dollars, which I think is significant.

The obligation of the military--concerning renegotiation and that is what I am going to talk about now--is just as much, even though not specifically stated in the statute, as the obligation on the Renegotiation Board. That obligation is to advise us fairly, surely, and frankly as to the minus as well as the plus signs with respect to the individual contractors who are turning out the items the services need. We cannot do our job if the military says, "Company so and so is a great outfit" and nothing more. We have to know what is the rate of rejections. We have to know their efficiency in the use of manpower and materials. We also have to know--this comes up time and time again--delivery dates. Here the company may not be at fault, if the military has specified impossible delivery dates.

The big decision that our board made was whether or not we would repeat the World War II practice and authorize the military departments to run their own renegotiation. I insisted that it should not be done for the very same reason that the judge and the jury shouldn't be too congenial.

The procuring officer has a responsibility to get the best material he can. When he makes that contract he is interested in that production and he is going to get that production, but he should have nothing to do with determining how much of the amount of money the company got it should retain. That decision should be made elsewhere. But the military does have the obligation of giving us what we call proper performance information.

Let us now return to the manner in which we handle a typical case. A company comes in with what it insists is a normal profit, shall we

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say, of 15 percent. We have to take into consideration, among many of the things I read, what normal earnings are. We spent the last two days trying to come up with something that constitutes normal earnings. Do we take the pattern of this particular company for the last 10 years and say, "This establishes a pattern of normality. Its earnings have always been in the range of from 12 to 15 percent. Therefore, 15 is all right. That is normal?" Then do we go and take a pattern of other companies in the same business and see whether that affects normal earnings?

When you reach that point you say, "That is normal. All right, what is reasonable?" Because normal obviously isn't the same as reasonable. Then you apply--suppose you start with the idea that 15 percent is normal. They are entitled to clearance. Suppose they made 20 percent and 15 percent is normal, let us see what is reasonable.

Did they have an increase in production? Was that increase defense stimulated? If it was and they were turning out gadgets uniform in size and so forth, then the more you turn out, the less your unit cost. How much of that shall they retain? How efficient were they? Your efficiency then must depend upon the efficiency with which the job is done by similar contractors, similarly situated, turning out the same item. Gathering together all that information, after a while you get to a point where you say, "This would be too little; this would be too much. The answer lies in between.

Now in World War II 95 percent of all cases were settled by agreement. It is essential that the vast majority of cases be settled by agreement. Otherwise, your whole procedure bogs down. In World War II, almost every industry that you could think of was either turning out its normal product faster to satisfy the great hungry military machine, or it was doing something else, away from its normal business, or it was engaged directly or indirectly in some phase of war production. What do we have this time? Nothing even remotely approaching that. We have companies bidding hand-over-fist against themselves for procurement. Why? Because there is not enough to go around. I will give you an illustration.

When a company does 3 or 4 million dollars worth of business--this was an actual case--of which the sum of only \$400,000 is renegotiable, how do you renegotiate it? How do you allocate overhead and so forth? Here you can't do such a fine job.

But suppose a company is making shoes and has for years, and sells them commercially at \$4.55, wholesale price. That is a pretty good indication that the price established in the competitive market is a sound price and contains a reasonable profit. Now suppose that company does some competitive bidding and comes in and makes the same shoe for the Army at \$4.55. The volume has not been increased. It

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is just turning out the same number of shoes, including the Army order, as it turned out before it had the Army contract and gets \$4.55 from the Army for every pair of shoes.

That company comes before us for renegotiation. Some people say that we should take some money away from it. I say, "Why?" Have we reached a point in this man's world where the military is entitled to a cut-rate price just because it is the military, when there is nothing in the picture indicating an increase in volume or that the company is making more per pair on shoes? I say no.

But whenever you have a situation where the military purchasing has increased the volume to the point where the cost per unit goes down, then you are in the area where excessive profits may arise. I personally am very much opposed to the provision in this statute which requires the renegotiation of companies that got their business on the basis of competitive bids. The sole reason for putting that in the act was because in World War II there were many companies that were taken out of their normal line of business and put on government work while some fly-by-night company started business with government contracts and built up excessive profits. That situation doesn't exist today. Therefore, I am extremely careful not to try to take away from a company something that it acquired as a result of sound competitive bidding because I don't think that is sound practice, and neither should you.

But when you are in the area of negotiated procurement, maybe the man representing the company can come closer to knowing what its costs are going to be than can the contracting officer. I could not come even relatively close to telling what those costs are going to be. Also, when you are negotiating a contract there is always a possibility that the price is going to be too high, but don't forget that renegotiation is only a one-way street. As I told Admiral Hague before this meeting, the area of renegotiation is one of the most dangerous areas if it is not handled properly; the law gives such broad authority that if that authority is not carefully exercised, bureaucracy will be running wild.

I have been trying for nine months, and I am meeting with a very small and disappointing measure of success, to convince our people, many of whom were in World War II, that I just don't believe in renegotiation conducted along the lines of crystal ball gazing. This school of thought places first one factor and then another in the crystal ball and comes up with what is called an "informal judgment." I want to know how they arrived at the judgment, what they used for a starting point, and what additions or subtractions they made along the way. But I can say, rather ruefully, that it has been very hard for me to make progress along these lines.

I say to my people, "Let us use reasonable earnings as the starting point." They say, "That is difficult to do." I say, "When you make a determination of excessive profits and you take the excessive portion

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away, what do you have left?" They answer, "Reasonable profits." I say, "Obviously, then, if you can get it that way, let us try getting it the other way."

The important thing in all of this is that you must have, in addition to rules and regulations, certain clear and concise techniques of application that are known not only to your own people but to the people in the field, to the contractors, and to the military. No one should fly by the seat of his pants and then blandly assure the world he has used the latest navigational aids to arrive at his destination. That to me is bureaucracy in its worst form.

I now come to the other problem that is very important in this picture affecting the military; that is, redetermination versus renegotiation. Since World War II, the procurement practices of the services have undergone substantial revision and have been greatly improved. I would suppose that the advance in procurement techniques of the last 10 years probably doubles the advance made in the 100 years before that.

Now the services, spurred by an inquisitive Congress, have done everything they could to protect themselves with respect to their individual procurements. The moment you know that the worthy gentlemen on the Hill are looking over your shoulder at everything you do, you are going to provide as many escape hatches as you can, with the result that you negotiate a procurement and then you say, "Let us see, we may be off base here, there, and everywhere. Let us put in a redetermination clause, and let us provide that when the contract gets up to 50 percent of performance, we will call in the contractor to discuss the price, and after a certain percentage of performance has taken place, we will determine the final price."

I appeared before the Munitions Board last spring. I know the Munitions Board very well. I was a member for three years. I said to its members, "The services have gone wild on the utilization of redetermination clauses. They are putting redetermination clauses in contracts when most everybody knows there shouldn't be redetermination in those areas." I said, "Not only that, but at least one of the services in certain cases, had redetermined the price after 100 percent performance has taken place." That is unusual; however, when you have a redetermination clause in a contract and you start redetermining the price at 80, 90, or 100 percent of performance what you have is cost-plus-a-percentage-of-cost, gentlemen.

Now when the manufacturer has to go through redetermination he might have to give something back to the Air Force on contract A even though he lost his shirt on contract B with the Navy. In our game everything is averaged over the whole year and that is what the contractor wants.

We have made some recommendations to Congress and one of them is this, that if there is going to be renegotiation, then just suspend

renegotiation, as has been done with the Vinson-Trammell Act. During the period renegotiation is in effect, Congress should forbid the military the right to have redetermination clauses in contracts because renegotiation means either what it says or it should be wiped out of the picture and let the redetermination clause be in effect. I think that makes sense, but the military isn't going to like it. We have been trying to get some agreement with the military on this problem of redetermination versus renegotiation for almost a year, but I know the techniques of heel-dragging just as well as they do and we aren't going to get an early answer.

I made a speech before the NAM in New York a month ago and I was unhappy to find that a business organization had circularized a lot of its companies and had come out with the conclusion that renegotiation was unnecessary "in this peacetime era." I said, "Now I thought you gentlemen had grown up. First of all," as I have said many times, "we should never have renegotiation in peacetime"--because of the many things I have mentioned this morning and others; "Secondly, if this were a peacetime era, you people wouldn't be howling because you wouldn't have the extensive military contracts you now have; and, third, I would like very much to have you tell the wives and mothers of the boys in Korea that this is a peacetime era."

I must say that most of the members were in complete agreement with me. Business must adjust itself to the difficulties that it encounters in military procurement. Business must--and most business is intelligent and recognizes this--for its own protection see to it and insist upon some organization that can run business through the mill and say, "Insofar as we are concerned, you are clean." Only in that way can you keep the crackpots and lunatic fringe boys from coming out with persistent attempts to cut down American business, and by and large I am happy to say business has bought that approach.

How well we can do this job in this extremely difficult half-in, half-out era, I don't know. I think we are making a certain amount of progress. I hope we can make more.

It has been a pleasure to be here. I understand that I will be subjected to some questions. Thank you very much.

COLONEL JOHNSON: Mr. Koehler, there has been some question about renegotiation of our contracts placed abroad. Would you care to give us a few minutes discussion on that?

MR. KOEHLER: Well, the act makes no distinction between domestic and overseas procurement. We obviously found it to be virtually an impossibility to renegotiate overseas procurement and have on several occasions requested Congress to amend the act. We did one thing with respect to procurement overseas for the Military Assistance Program. We made a deal with the Secretary of Defense that we would exempt such

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procurement if in return he would guarantee that in no case would we pay more than 110 percent of the domestic price. That has worked very well. On planned procurements, such as when the military wants to make a deal with one of the British companies for jets, we exempt them. We have no alternative. If the military says in its own wisdom that it needs to procure such and such from so and so overseas, who are we to second-guess them.

QUESTION: I was wondering, Mr. Koehler, on the statement you made that you felt in the case of competitive contracts there should not be any price renegotiation; on the other hand, on competitive contracts there shouldn't be any price redetermination.

MR. KOEHLER: That's right.

QUESTION: Now I am wondering about the case where a competitive contract is entered into for a given item for which there is not sufficient practical experience for the establishment of the price, should there be any method for the Government to recapture excess profits in that instance?

MR. KOEHLER: What in effect you are saying is: How do you correct a mistake in procurement? Because if you have an item and there is not sufficient background by which you can determine the cost, what you should do is to let the contract on a straight cost basis until you get sufficient experience and then go on a negotiated basis.

I made my point so strongly during my talk simply because it just isn't right for anyone in this country to go into competitive procurement, pick out the lowest responsible bidders and then say, "Well, boys, if you lose on this job, it is too bad, and if you make on it, give Uncle Sam some." I just can't buy it unless you have a situation such as you had in World War II where the fly-by-night boys were coming in and regular suppliers couldn't bid. Then you don't have competition.

COLONEL JOHNSON: I think we will all agree with you on shoes, on that area, but how about 22 caliber ammunition?

MR. KOEHLER: I never bought any ammunition. I don't know what the facts are. What is different in 22 caliber ammunition? If you are going into great quantities, that is taken into consideration when the bid is submitted and the bidder is trying to cut his bid down to where he is sure he will get the contract and still be sure of a reasonable profit. That is your check on excess profits, the area of strict competition. If you don't have real competition, then my argument falls flat on its face.

COLONEL JOHNSON: That was my argument. For 22 caliber ammunition you have only two suppliers.

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MR. KOEHLER: I have seen bids come into the Navy from four or five companies which split a few cents up and down the line. When I see something like that, I say, "All right, boys, throw them all out."

QUESTION: I notice on the income tax form on the back of the table that if an individual makes over \$300,000 these days he pays 92 cents out of a dollar back to the Treasury. If a similar factor is applied to profits and accruals, I wonder if Uncle wouldn't get money back in excess profits from many other people and, if so, whether renegotiation would be necessary?

MR. KOEHLER: The trouble with excess-profits taxes is that nobody has ever been able to devise one without arbitrary rules. Every company is different. You are trying to lay down a uniform rule that applies to everybody in the picture. The reason they are trying to get rid of excess-profits taxes is because of small business. They can't expand. Excess-profits tax operates like any uniform table, it doesn't take into consideration the efficiency, this, that, and the other thing.

The essential purpose of renegotiation is not to get money but to insure close original pricing and thereby save manpower and materials. If any of the services entered into a procurement contract--you should bear this in mind, gentlemen, because it is extremely important--that is overly generous, it is an open invitation to the manufacturer to waste manpower and material. If we can build up inducements to bring him around to the point where he will price closely but honestly, then we have accomplished something.

I would like to go on with that point for a moment. At present the tendency in military procurement is for the Government to assume too much risk, and that is bad, because there should be more and more risk on the individual contractor. The more risk on the individual contractor, the greater the profit he should retain. An excess-profits tax can't do that; renegotiation can if properly administered.

I made a speech before NSIA. It wasn't really a speech. They were having a seminar. They had five speakers on government procurement. One of the speakers made some complimentary remarks about renegotiation, and finally the chairman asked me if I would care to make a few remarks in return.

I got up and said: "I have listened to all five speakers this afternoon and the thread that ran through every speech was that 'We are being forced to do this, that, or the other by the military through these contract clauses. We don't like it.'" I said, "I don't quite understand what you men are talking about. You are saying openly that the customer is dictating the terms of all the contracts. When I went to law school, it took two to make a contract. The trouble is if company A doesn't like a contract, he takes it anyway because he is afraid if he doesn't company B will get the contract. You can't stand

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that type of competition so all of you are gradually sinking down in a morass of your own creation." That is true.

Now the time will come, if this thing ever levels off, when it is going to be more and more difficult for the military to get companies to come in on business, and if commercial business booms and picks up to the point where the companies have plenty to do without military procurement, the military is going to have some long, hard thinking to go through.

QUESTION: Mr. Koehler, you suggested the possibility that re-determination might be eliminated in favor of renegotiation.

MR. KOEHLER: That's right.

QUESTION: It would appear that the services would be interested in what happened to the money that goes back. I mean by that the appropriations now have to pay for procurement and what goes back for the Government through renegotiation goes to the Treasury. Would you comment on having that money go back to the services so the true cost of procurement would show?

MR. KOEHLER: As a matter of fact, I recommended that, but I am not sure that is the proper answer. Congress would say, "We gave you so much money to do the job. What comes back shows you could have done the job better." But to dangle a little sweetmeat in front of the military services, we did recommend that what they would recoup would go to them.

QUESTION: Would the elimination of redetermination preclude the incentive type of contract?

MR. KOEHLER: No. I think that should be encouraged because that is where the military people are much more competent than the renegotiation people ever could be. The incentive type contract wouldn't require it but it wouldn't preclude it.

QUESTION: As I understand it, renegotiation is entirely a search for excess profits and never results in awarding a larger profit?

MR. KOEHLER: Yes, renegotiation is a one-way street. We never give to anyone who has lost. We always take away. We never give for obvious reasons. That has its disadvantages because, take a company that loses on its military business substantially in 1950, makes substantially in 1951, you can carry forward a loss just as you do an excess-profits tax for one year. Perhaps you should be able to average it over a three-year period. We have to look at it every year that comes along and that can work, and often does work, serious inequities.

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QUESTION: Can you announce or make known that a company did not make a profit to which it should be entitled? Although you can't give it money, can you publicize the fact that it didn't do well?

MR. KOEHLER: We can't publicize anything. We were upset because we couldn't give information on which we made our recommendations to the military, mainly because they are based upon income tax information which we get directly from the Bureau of Internal Revenue, and we are forbidden by law to make that information available. Even when I go up on the Hill and I give to Congress the results of renegotiation by companies, I always use code letters. We have in our possession trade secrets which it might be disastrous to make available.

QUESTION: Sir, would you discuss a little bit your organization and procedures--in other words, what your regional boards do and what the statutory board does? Is there any review and what is the right of appeal from the various companies?

MR. KOEHLER: First of all, the statutory board is a five-man board located here in Washington. We have six regional boards and they are five-man boards. They are in Boston; New York; Washington, D. C.; Chicago; Detroit; and Los Angeles. The Chicago board has the largest amount of business; New York, Detroit, and Washington are close--second, third, and fourth; and Los Angeles and Boston have the least.

All filings by individual companies must come to Washington. They are filed with our board. I insisted that there was no point in taking an obvious loss case and sending it to the field and have the field do the obvious thing on clearance. All cases are filed in Washington where they go through a screening committee, and the screening committee does the accounting work and then presents its results to the board. These cases involving loss or cases involving very small amounts of profit where no reasonable man could say they are excessive are screened with the result that 56 percent--the last count--of all filings never got to the field. When a case gets to the field it has been through the screening committee and there is at least a reasonable chance that excessive profits are present. Then the case is handled at the field level.

The two members in the organization that run the case are an accountant and a renegotiator. The accountant's job is to see that all the information is covered. The renegotiator works it out, applies the factors, and so forth. If the contractor agrees and if it is a B case--a B case is a case where profits are lower than \$400,000--then the regional board says, "O. K., we agree" and that is the end of it. That is finality. If it is more than \$400,000, and A case, those come to Washington for review, and the Washington board takes its action.

Now if the contractor disagrees at the regional board level, it then becomes an impasse case and, whether A or B, he has the right of

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appeal to the statutory board for a final resolution. If the statutory board finally makes a recommendation and the contractor doesn't buy it, the contractor can go to the tax court, and that is the final word. He can't go to the Circuit Court of Appeals. He is stopped at the tax court. To all practical purposes our decision is final because only in very rare instances will the tax court upset a determination of the board.

COLONEL JOHNSON: Mr. Koehler, does that 56 percent figure that you gave include people who report for renegotiation but who have less than \$250,000 of business?

MR. KOEHLER: That's right. Now on refunds, the 1948 act has been in effect for several years. We have just about cleaned up the cases under the 1948 act. I think we have possibly 100 left. The refunds under the 1948 act came to what I consider to be a very low total of about 14 million dollars. I personally thought then and I still think that the 1948 act was a mistake. I, of course, don't think so of the 1951 act.

We have received very substantial amounts of money in the form of interim voluntary refunds. A company, seeing that it has a maximum of profit--35 to 40 percent--early in the game, if it is well-advised, will go to our regional board in January or February or even before the year's close and say, "We are making too much money. We want to give some back." Then when he comes before us for renegotiation, he can say, "I really increased my risk because I cut my profit down in January." Most of the people come in the day after Christmas and shortly before the end of their fiscal year and say, "We want to give you some money." Then we could say, "Why don't you just hold it and we will take it away from you with some more later on?"

QUESTION: Knowing that military procurement has been a very special area for criticism recently, how well in your opinion did we do in procurement in general and close pricing in particular?

MR. KOEHLER: Well, I will put my Navy hat on now and take the other one off. I think you did very well. I think the services are doing very well. I think that there are some basic criticisms of the services and I am in effect criticizing myself for what we did in the Navy and what the other services have done.

First of all, you try to do the impossible. It is impossible in many cases to come to even a reasonable approximation of the cost when you negotiate a contract. If that is true, then the thing to do, as I mentioned before, is not to try to negotiate a fixed-price contract. Insist on doing it first of all on a cost basis until you get experience. Then switch over to a fixed-price basis and if you get to a point where experience gives you enough background to negotiate a fixed-price contract and you call in three or four suppliers and you do a good job of negotiating and make a proper award, then you should stick right by

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your guns and say, "This is it; no redetermination, no escalation, no nothing." And if the company makes money, it should keep it, because when the company comes before us I insist that the company which has done a top-notch job is entitled to keep the rewards of its labors. Otherwise our operation is penalizing the efficient to the advantage of the inefficient. So I think that is the answer.

You can't lay the trouble at the feet of the military any more than you can blame other areas in Washington. As your congressional tide of criticism mounts, the individuals down the line in procurement offices will try to do their best to provide enough escape holes for themselves..

QUESTION: What are the criteria under which a manufacturer must file? Does he know what he has to file?

MR. KOEHLER: Oh, he does, indeed.

QUESTION: How does he know that and about how many returns do you get a year?

MR. KOEHLER: We have received for fiscal year 1951 filings about 25,000 returns. It is apparent that the excessive profits in the 1951 returns--with some obvious exceptions--will not be very great but that is because a large part of that work was the tooling-up period. They weren't getting into production so much. The year 1952 was one of real production and the amount of money kicked back, I think, will be rather substantial; 1953, the same way.

How the manufacturer knows? Obviously all of our regulations are published in the Federal Register and they know it. It is the small fellow who doesn't know. He gets returns for renegotiation and throws them into the waste basket. He thinks it is just another one of those ideas of the Washington dream boys.

The real area of trouble is with brokers and manufacturers' agents who are subject to renegotiation, many of whom have their offices in their hats. Those are the boys you have to run down and throw a hock into because the company that files has to divulge to whom it pays fees. We have case after case where a big company says, "This fellow got 25,000 dollars," but the broker never heard of the company. He never got a dime. Those are a few of the things that make life worthwhile.

QUESTION: I am thinking about the relation between excess-profits taxes and renegotiation. Would it be desirable if renegotiation were available outside military procurement, that is in an instance where, let us say, Sears-Roebuck is going to buy a year's supply of paint from the Pittsburgh Paint Company? I don't think the courts provide a means of renegotiation there.

MR. KOEHLER: What would be the authority of the Federal Government to move in that area?

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QUESTION: I don't know.

MR. KOEHLER: I can tell you, none.

QUESTION: A little while ago it was not felt that the Federal Government had authority to set up review boards in matters of labor disputes.

MR. KOEHLER: Can you imagine anything more startling, more purely socialistic than the concept of the Federal Government renegotiating a Sears-Roebuck profit on a deal it made with G.M.?

QUESTION: Is that more remarkable than excess profits?

MR. KOEHLER: Sure, because the American taxpayer puts up the dollars for government expenditure. We pay the bill. But what Sears-Roebuck does with its money is none of our business.

QUESTION: I am not suggesting we do that.

MR. KOEHLER: I am trusting no Naval officer would.

COMMENT: There was an article on renegotiation by Drew Pearson this morning.

MR. KOEHLER: He doesn't seem to know the difference between re-determination and renegotiation. But he did make a point that has real significance which concerns me. When you have General Motors holding 3 billion of defense procurement, that raises problems which will plague the new Administration. I speak guardedly because I am a not offensive about it, as you will notice.

Now Drew Pearson undoubtedly was talking about redetermination and I don't know where he got his facts because I don't recall that any of the services ever determined fixed rates of return applicable to any contract involving redetermination. If they do, then, my indictment of the military in this area becomes a lot more serious than it has ever been in the past. But I don't think Drew Pearson knew what he was talking about.

QUESTION: There has been a lot said and written about the evils of the cost-plus-a-fixed-fee contract. Is that the most difficult type of contract to negotiate and, if it is, will you comment on it?

MR. KOEHLER: I am surprised to hear you say that there has been a lot of evil said about it. I think the cost-plus-a-fixed-fee contract is a good contract in certain cases, if properly handled and if you do it in an intelligent way. One of the troubles with the cost-plus-a-fixed-fee contract is that you have the General Accounting Office second-guessing everything you do.

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All we do--to answer your question specifically--is to segregate all contracts of that type from other contracts so that we won't be allowing the contractor a greater return than the services allowed him in the first place. In other words, you have to treat the problem separately. You might have a 15-million-dollar contract for building an airplane with a 2 percent fee.

QUESTION: I am thinking about the time lag in the settlement of these cases. The General Motors contract represents a lot of money to stockholders. You indicated there that you had finished 1951 but 1952 hasn't come up. For 1952 General Motors has determined its profit. It has turned in its earnings reports and whatnot.

MR. KOEHLER: You misunderstood me. I said that the filings for 1948 were almost completed. The filings for 1951 are by no means completed. If we have 90 percent by next September, we will be doing very well. After all, we have 5 million dollars to run this whole show; 5 million dollars covers our entire operation, unlike World War II when the thing was run by the military. You can imagine it isn't easy to get housekeeping and all these other things. We have to pay for those. So our total organization doesn't run over 700 people.

QUESTION: I was thinking of the tremendous business time lag. The company doesn't know whether it is going to get 14 or 15 percent.

MR. KOEHLER: The company can come out very closely and it does set up reserves. We have stated in our regulations that to set up reserves for renegotiation is no indication of what we are going to do. We don't pay any attention to it, but a company knows the rules very well. Certainly a company can come very close to figuring out how much we are going to nick it for. It says it can't, but it can.

QUESTION: Is the statutory board subject to change 20 January 1953?

MR. KOEHLER: Yes, the statutory board is subject to change on 20 January 1953. The Secretaries of the Army, the Navy, and the Air Force and the head of GSA each nominate a member to the statutory board, and the President then nominates a member also and the President selects the chairman. The term is not a fixed term for any of them. In addition the positions, particularly that of the chairman, are considered well paid in government circles. To answer your question more specifically, my resignation has already been submitted. Since my successor has not been named--or I will put it this way, if named, I do not know about it--I would hope to stay on for a period of no more than two or three weeks at most to make the transition as smooth as possible. My time is up and I think that is fine. Give the other boys a chance.

COLONEL JOHNSON: If you are to go, Mr. Koehler, I am certainly glad we got you down here before you leave. Thank you very much.

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