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RENEGOTIATION AND PROFIT CONTROL

16 February 1956

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

Mr. Thomas Coggeshall, Acting Chairman, Renegotiation Board, Washington, D. C., was born in Auburn, Rhode Island, 6 November 1891. He graduated from Harvard with A.B. (magna cum laude) in 1913. Engaged in Foreign Trade and Foreign Banking, both commercial and investment, 1917 through 1941, principally with the First National Bank of Boston and the First Boston Corporation, from which he resigned as Foreign Vice President, 31 December 1941, to engage in various war work assignments with the United States Government, as follows: United States Treasury, Division of Foreign Funds Control, Special Advisor on Trade and Foreign Exchange. Reconstruction Finance Corporation, U. S. Commercial Company, Special Director for Spain. War Department, Army Air Forces, Member and Vice Chairman of the New York Price Adjustment Board, 1943-1947. (Recipient of Exceptional Service Award from the Secretary of War, July 1946.) After returning to private affairs for a year and a half, resumed work in postwar Renegotiation in January 1949, as a member of the Air Force Division of the Armed Services Renegotiation Board, serving successively as Vice Chairman and Chairman until January 1952. After spending three years as a Board Member of the Washington and New York Regional Renegotiation Boards, he was appointed to membership to the statutory Renegotiation Board, Washington, D. C., 1 March 1955. Elected Acting Chairman by the Board effective 1 November 1955. This is his first lecture at the Industrial College.

RENEGOTIATION AND PROFIT CONTROL

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GENERAL CALHOUN: We are privileged to have as our speaker this morning the Acting Chairman of the Renegotiation Board, the Honorable Thomas Coggeshall.

The Board was created by statute in 1951 as an independent activity of the executive branch of the Government. The purpose of the Board was to eliminate excessive profits arising out of contracts with the military departments.

We have asked our speaker to discuss the principles and policies involved in renegotiating military contracts. He will also discuss the application of these principles to those contracts in which Government-owned plant and equipment is involved.

As you know from his biography, our speaker has had a long and illustrious career, both in private banking and investment and with the Federal Government. He has served continuously in the field of renegotiation since 1949. He was appointed by the President to the Board almost exactly one year ago, and he was elected as the Acting Chairman by the Board in November of 1955.

It is an honor to present Mr. Coggeshall.

MR. COGGESHALL: General Calhoun, General Hollis, and members of the Industrial College of the Armed Forces: I consider it a privilege to have been requested to address so distinguished a group of selected senior officers of the three armed services--or the four--I must not forget the Marine Corps--the Army, Navy, Air Force, and Marine Corps--as well as the smaller group of higher civilian officials of the United States Government.

I consider it a privilege. I am not going to say I am not accustomed to addressing so large a group, I don't say it is a pleasure. I considered it was an obligation to accept the invitation. I shrank a bit. I think it was in fact two or three days after I received General Hollis's letter inviting me to take on this task that I mentioned it to my wife when we had the occasion to see a play which I am sure a number of you people who are in the military services were interested in,

"Valor Will Weep." Those of you who saw it may remember the opening scene wherein two GI's were huddled together in the cold trying to get a little warm. One said to the other, "We are going to get a lecture today." The other one said, "This is a hell of a time for a lecture." The first one said, "Any time is a hell of a time for a lecture."

After hearing that, my wife said, "Are you still going to accept General Hollis's invitation?" I said, "I don't know." That held me off for about a month, gentlemen. There were other reasons, but that headed them.

With that by way of introduction, I have need to explain that this lecture will be what comes out, what the secretary can get into the transcript, of what I have to say. I have only an outline. I am going to talk to the outline. I have been too occupied with the pressing duties of the Renegotiation Board since my acceptance to prepare a lecture. I am not only Acting Chairman of the Board, but there is still a vacancy on our Board. Therefore, I am doing what I was doing as a member of the Board prior to Mr. Roberts' resignation--probably a number of you know him or have heard him--but I am also looking after what were his duties. Sometimes I find the 24-hour day a little short to keep up with things.

Before discussing what renegotiation is, even though this group here probably has more knowledge of it than the generality of the American public, I will mention first what renegotiation is not. It is not excess profits taxation. Renegotiation, in dealing with excessive profits, represents a sharp distinction between excess profits covering the wartime excess profits and postwar excess profits tax, which was purely automatic and mathematical, and was allowing for no exercise of judgment.

There is another widespread belief in some quarters that, when you talk about renegotiation, you are talking about contract termination. This is incorrect. Nor is it price redetermination of an individual contract, which I am sure all of you have probably heard about, and probably have had experience with; that is, determining the profits on an individual contract, reviewing them, in accordance with the terms of the contract, at the 30 percent stage of completion or the 40 percent stage, whether there was to be a two-way redetermination or just one way, downwards, and so forth and so on.

Now I will discuss what renegotiation is. As General Calhoun said in his very nice introduction, it is the purpose of renegotiation

to prevent defense profiteering by eliminating what are found, by a Board charged with that responsibility, to be excessive profits on defense contracts and subcontracts on an overall fiscal-year basis.

Renegotiation had its start in 1942. The first Act was approved 28 April 1942. It was written for what was really redetermination of the results of an individual contract, contract by contract, and it fell of its own weight, or would have fallen of its own weight, if it had not been for the amendments made in October 1942. I think the date of the enactment of the amendments was 21 October. That is immaterial. It would have fallen of its own weight, because there was a violent protest, very properly a violent protest, that merely to reduce the profits on a contract which was found to involve excessive profits, and to ignore the results of contracts which had either a deficiency of profits, or actual loss, which could well result in a contractor having no profits at all to show for a year's work under renegotiable contracts, was wrong.

The Act, before any such impossible results were reached, was amended, at the insistence of the then Assistant or Under Secretary of War, the great Judge Patterson, and his General Counsel, Charles Pengra of Boston, who was the first counsel of the War Department Price Adjustment Board.

The Act could not have been administered in the form in which it was first passed. It was utterly inequitable. The first full year of operations, 1943, was a trial-and-error period, both as regards the administration of the Act and the response of contractors.

Results varied. Some were good, some bad. Out of this experience there was a move to revise the Act in the fall of 1943. It was consummated in the second Act known as the 1943 Renegotiation Act. It was a part of the Internal Revenue Act of that year, which was not put before President Roosevelt for final signature--in fact, he did not sign it; it was passed over his veto on 25 February 1944. He vetoed the Internal Revenue Act in the famous exchange of compliments with "Dear Alben" Barkley. It wasn't because of the renegotiation provisions, but it was because of other provisions in the tax act. The Internal Revenue Act of that year has been known as the Internal Revenue Act of 1943, although not passed until 25 February 1944, and the Renegotiation Act is also known as the Renegotiation Act of 1943.

That Act extended through the war. Shortly after the Japanese surrendered, the termination date for liability for renegotiation was

fixed at 31 December 1945. Between the beginning operations of the 1942 Act and the extensive operations of the 1943 Act applicable to contractors' renegotiable business for a period of three years, findings of excessive profits, determinations of excessive profits, resulted in recoveries amounting to over 11 billion dollars gross, representing by estimate something like 3 to 4 billions net after Federal tax credits.

The renegotiation authorities have never been in a position to give the exact net amount of recoveries, and have often been challenged on the figures they gave about recoveries as being true figures. It gets back to the law. The basic concept in the law is that a contractor's renegotiable profits are not firm profits until such time as they have been reviewed by the properly constituted authorities. I will also explain, renegotiation does not mean a refund, necessarily; it means review, necessarily; and after review there may be a finding of excessive profits, and then the refund matter comes in. It is review first, and refund, perhaps, not necessarily, afterwards. If the finding is that there were no excessive profits, the contractor receives a clearance for the year concerned.

Therefore, the recovery, the finding of excessive profits, is made in theory prior to the profits being subject to Federal tax. Of course, inasmuch as a contractor does not even file for renegotiation until four months after the close of his fiscal period, the Internal Revenue Service does not allow him to postpone filing a tax return and making such payments as are called for, until his renegotiable business has been reviewed. He makes his tax payment first on all his profits. After he has gone through the renegotiation process and a finding has been made of excessive profits prior to Federal tax, for convenience' sake, and it is only for convenience' sake, he applies to the Internal Revenue Service for a credit on that portion of his profits which has been found to be excessive.

In other words, if we make a finding of a million dollars and he has paid 700 thousand dollars tax on those excessive profits, he gets a credit--the tax people figure the credit--we don't--of 700 thousand dollars, and he pays, on account of his renegotiation refund, the remaining 300 thousand dollars in question. When the finding has been made he makes the payment, either as the result of a bilateral agreement, which is the usual outcome, or, in the small minority of cases, by unilateral order. When his tax credit has been determined by the Internal Revenue Department, payment of the balance due is made. The military services, not the Renegotiation Board, act as collection

agents--the Army, Navy and Air Force. There are other departments which also act as collection agencies--the Atomic Energy Commission, for example.

But that gross refund of one million dollars is credited on the books of the Treasurer of the United States to renegotiation recovery. What had been paid by taxes in the first instance is transferred from the account of Internal Revenue to the account of renegotiation.

So the only firm figures we are ever able to give are the gross figures. The Federal tax credit was devised in the war to take the place of filing an amended tax return and requesting a refund from the tax people of money which was never properly tax money.

We ran into that in the early phases of the wartime renegotiation. I remember one of the most important contracts we settled was one that came up for renegotiation in the Air Force office in New York. There was a finding of 40 million dollars, to which the contractor agreed, and when it came time for working it out, after it was approved by the War Department Price Adjustment Board, and it came time to fix the terms of payment, the president and treasurer of the company said: "This is all very well. We recognize that we realized 40 million dollars of excessive profit. What are we going to do for money to pay it? We have already paid the Internal Revenue some 32 million dollars by way of taxes." Colonel Phagan, our Price Adjustment Officer, who was a great tax expert, dashed down to Washington and took it up with the War Department Price Adjustment Board. They had a conference with the Treasury. Out of that, the Treasury conceived the idea of authorizing contractors to apply for tax credit, because they admitted frankly that, under wartime conditions, it was unlikely that the tax returns of any important company would be examined and finalized prior to the close of the war. Therefore, it would have been impossible. It was typical of the way renegotiation has been handled. It has always been handled in a very pragmatic fashion.

Speaking of those recoveries of over 11 billions gross in wartime, that was never considered the chief accomplishment of renegotiation by the administrators thereof. There were tremendous amounts of voluntary refunds and price reductions made by contractors, which undoubtedly would not have been made if it had not been for the existence of the Renegotiation Act. In other words, we did our best to encourage contractors to renegotiate themselves. After the first

year we had exceedingly satisfactory results in that particular, over and above the 11 billion dollars of recoveries.

That 11 billion dollars of recoveries, as I recall it, represented bilateral agreements in something like 30,000 cases. Over and above the bilateral agreements numbering 30,000, there were unilateral orders to the tune of less than 2,000. Of those approximately 2,000 unilateral orders, no more than 850 were carried to the Tax Court. In other words, bilateral agreements in connection with refund recoveries were reached in approximately 95 percent of the cases, and in the remaining 5 percent where the determination was made by unilateral order, less than 50 percent went to the Tax Court; and of the 50 percent which went to the Tax Court, more than 50 percent again were withdrawn in the following years, on the motion of the contractor. I think something like 250 cases have been tried by the Tax Court, and there remain from wartime a small number of the original 850 or so that went to the Tax Court. We have, then, a record that the renegotiation authorities need not be ashamed of.

I want to touch now on the windup of the 1943 Act. Work in the field was generally completed between the end of 1946 and the middle of 1947. I think some field offices closed at the end of 1946, and I don't recall any being open beyond the middle of 1947. Of the boards in Washington that had the final review and appeals before them, the War Department Price Adjustment Board, the Navy Price Adjustment Board, the War Shipping Administration, the Maritime Commission, the Treasury, and the RFC, the chairmen of those divisions, constituted the War Contracts Price Adjustment Board for appeal. That appeal board was in existence, I think, through 1949; but some of the departmental boards in Washington, I think, closed in September of 1947, and others closed before the time the War Contracts Board went out of existence.

Before the final windup was completed, a new Renegotiation Act was passed 21 May 1948. There was passed an Act with very limited coverage, at the insistence of the Department of the Air Force. Of course, as you gentlemen know, everything in the Defense Department must be coordinated, and it was coordinated with the Department of Army and with the Department of Navy, and had the endorsement of the Secretary of Defense, the first Secretary of Defense, that great figure, James Forrestal. He and Judge Patterson were the two men who were primarily responsible in the upper level for the administration of the Renegotiation Act in the war.

This new Act was passed 21 May 1948, with little or no publicity. It was done at the request originated by the recommendation of the President's Air Policy Commission, headed by Mr. Finletter. That was prior to his becoming Secretary of the Air Force. In the summer or spring of 1947 the President's Air Policy Commission was appointed and started its job 1 July to deliver a report and recommendation to the President by 31 December 1947. I am sure you are all acquainted with that momentous report, called "Survival in the Air Age."

That led to the request of Congress for an extension and additional funds for the development of the Air Force in line with the program projected by the report of the President's Air Policy Commission. The Air Force had only shortly before become separated from the War Department. That is, the War Department split into the Department of Army and the Department of the Air Force, as you know; and the Under Secretary of the Air Force, Mr. Arthur S. Barrows, who was the first Under Secretary of the Air Force, wondered what he could do to be sure that only fair and reasonable profits were realized on the tremendous sum of 5 billion dollars requested that year for the expansion of the Air Force, under the Second Supplemental Deficiency Appropriation Act, I believe it was called.

He was advised by Mr. John McCone, who was then acting as adviser to Mr. Symington, the first Secretary of the Air Force, to ask for renegotiation. "Oh, no," he said, "I heard about that in the war." McCone said, "I went through it and we stated in our report to the President that, if this program is carried out, we should have renegotiation, or something like it, to protect the taxpayer's interests, the Government's interests." He said, "The Vinson-Trammel Act is no proper protection." So Mr. Barrows was persuaded to ask for it.

When it was asked for after being coordinated in the Department of Defense, a bill went through the House Ways and Means Committee, and thence to the Senate with next to no delay. On 21 May 1948, the Renegotiation Act of 1948 was established in a rather different form--a quite different form from the 1948 Act. It pointed back, however, to the procedures and principles of the 1943 Renegotiation Act, taking into account changed economic conditions. It was limited at that time to negotiated contracts and subcontracts thereunder for aircraft and aircraft parts. It could have been extended at the pleasure or the decision or the discretion of the Secretary of Defense on 1 July to shipbuilding and construction overseas, but it was not.

So for the first year that Act was limited to aircraft and aircraft parts. It was not only limited to aircraft and aircraft parts, but was also limited to contracts and subcontracts entered into on and after 21 May 1948. In other words, performance going on at the time under contracts then in existence did not come within the purview of the Renegotiation Act of 1948. Secondly, only contracts making use of the funds appropriated at that time were subject to renegotiation.

So we had quite a circus with that Act the first year or so. The Vinson-Trammel Act at that time was not suspended. It was suspended a year later, retroactively to 21 May 1948. At the time contractors were subject to double jeopardy--and I should add that the renegotiation authorities were also subject to at least double jeopardy. If the Vinson-Trammel demand had been made and we had to make findings of excessive profits under the Renegotiation Act, I would say we would have been subjected to at least double jeopardy.

The suspension of the Vinson-Trammel Act retroactively to 21 May 1938, was provided in the extension of the 1948 Act somewhere in the summer of 1949. At that time provision was made to cover contracts for the other military departments, that is, contracts which were negotiated, not let as a result of competition, which contracts were never subject to the Renegotiation Act of 1948, negotiated contracts and subcontracts thereunder let by the Army, Navy, Air Force, and the Department of Defense, which made use of renegotiable funds.

By degrees, it worked out pretty well. It had very limited coverage. That Act was administered by the Military Renegotiation Policy and Review Board in the Office of the Secretary of Defense, consisting of the chairmen of the three divisions, Army, Navy, and Air Force divisions of the Armed Services Renegotiation Board. Those three divisions were in the offices of the Secretary of the Army, Secretary of the Navy, and Secretary of the Air Force. It was a joint board, not a unified board. But any decisions made by any one of those three constituent divisions of the Armed Services Renegotiation Board were subject to the approval of the chairmen of the other two divisions of the Military Renegotiation Policy and Review Board. The chairmen of those three divisions wore two hats; one as chairmen of their own divisions, the other as constituent members of the Renegotiation Policy and Review Board.

It was going on that way, doing pretty well in a complicated job. It was always considered, to use Mr. Barrows' words, a pilot-plant

operation, set up for "when, as, and if;" and when it was so set up we were thinking of the critical situation in Berlin, rather than the one which came to a head in Korea in 1950. The minute the "when, as, and if" broke in Korea, steps were taken to introduce a new renegotiation bill in the Congress, with vastly increased coverage. Hearings were held in the fall of 1950 in the House Ways and Means Committee. The Congress adjourned before it came to the floor, so it started all over again when the new session started in January, 1951. The prior hearings in the House Ways and Means Committee were considered sufficient; there were no hearings in the Senate Finance Committee. After the usual differences between the House version and the Senate version were hammered out in conference, the bill went to President Truman. It was enacted into law by his signature on 23 March 1951.

That Act was very similar--there were some changes, but it was very similar in its coverage--as well as in its principles and procedures--to the 1943 Renegotiation Act. There were moderate changes, based on experience. The principal change was the organization. The wartime board and the 1948 board were in the Department of Defense, or rather the constituent military departments, plus, in wartime, as I said earlier, the Treasury, RFC, the Maritime Commission, and the War Shipping Administration.

The Congress, this time, after considerable thought and discussion, felt it was advisable, as General Calhoun said, to establish a board independent of the military, in the executive branch of the Government. The Board must consist of civilian members, five, appointed by the President, with the advice and consent of the Senate--just as in the case of treaties. No member of that Board shall engage--a provision of the law--actively in any business, vocation, or employment other than as a member of the Board.

This Board took office on 3 October 1951. I believe this College was addressed by the first chairman some years ago, Mr. John T. Koehler. He was succeeded by Mr. George C. McConnaughey 2 or 3 years ago, in 1953, as chairman. Mr. McConnaughey resigned over a year ago, and Mr. Roberts became chairman in December 1954. I became acting chairman last November. Mr. Roberts had served on the Air Force Renegotiation Board in Detroit in the war, and had been the chairman of the Military Renegotiation Policy and Review Board from its inception until he was appointed to the Renegotiation Board on the recommendation of the Secretary of the Air Force and the Secretary of Defense--appointed by the President.

All told, nine men have been members. We are four at the moment. There is still a vacancy on the Board.

The Congress considered it desirable to separate renegotiation from any possible direct connection with procurement, and the stipulation was made by the Congress in the Act that the Board could not delegate authority to anyone not strictly responsible to it or to anyone connected with procurement.

The Board functions by delegation of authority through regional boards. The Renegotiation Board in Washington itself is not a processing Board in the first instance. We have had six regional boards. We have four now. There was one in Washington to begin with, which made for a certain amount of confusion. That was terminated two years ago--nearly two years ago--30 June 1954. There was one in Boston which was terminated last March. It turned out that there was not a sufficient number of contractors coming up for renegotiation in that vicinity to justify an independent Board. With the liquidation of both those Boards, the responsibility for processing open cases was transferred to the New York Regional Renegotiation Board, which is responsible for the processing of perhaps 40 percent, roughly, of our contractors who are subject to renegotiation. They take care of pretty much the whole Eastern seaboard.

We have a regional board in Chicago which covers the whole Middle West down through Texas. We have one in Detroit which is definitely for Michigan, and one in Los Angeles which is responsible for the entire Pacific coast and Rocky Mountain area.

The important end of the coverage of the 1951 Act, as in wartime, is the military services, the military departments under the Department of Defense, plus the Atomic Energy Commission. The Department of Commerce is included largely because of its Maritime Agency. Some fifteen other agencies are also included.

The Congress, at the time this Act was adopted, undoubtedly had in mind that we might find ourselves right in a third World War, and I would say they set out to cover the waterfront, to an extent which experience, at least since the last two years, or since the Korean War was settled, has found of very little consequence. There is a provision in the Act that provides that all contracts with what we might call peripheral agencies can be exempted if they are found to have no direct connection with the defense effort.

I am going to skip some details, I think. I see that my time for the so-called lecture period is running a little short. Some of these details, if they come up, I will answer in the question period. I would like to get on to something that I think you are more interested in, perhaps, rather than discussing exemptions and various things in regard to which you may have further questions, such as the increase in the statutory floor from 250,000 dollars to 500,000 dollars, common control, consolidated renegotiation, partnerships, and other technical matters, about which I will be glad to answer questions when we come to that phase.

I think I will try to get on to what are the two most important aspects of renegotiation. First, there must be an agreement on what sales are renegotiable in the year. Secondly, there is the matter of segregation of costs and expenses--what costs and expenses are properly allocable to renegotiable sales. In renegotiation, the statutory provision is much broader than it is in contract redetermination or military contracts. For instance, it is unusual, I believe, certainly on redeterminable contracts, to take interest as a charge, or overtime as a charge, and matters of that sort, which are not proper charges in military contracts. We are bound by statute, not by procurement cost principles, in determining the segregation of costs and expenses, along with the segregation of sales.

There are a number of types of exemptions set up by statute which I will not go into at this time. I will be glad to answer any questions connected with them. There are a large number of mandatory exemptions and certain permissive exemptions.

Following the regulations, a contractor must file his report on or before the first day of the fifth month following the close of the fiscal year. He files that with the Renegotiation Board in Washington. Assignments are made to the proper regional boards for the conduct and completion of renegotiation in cases involving less than 800,000 dollars worth of renegotiable profits in a year's time, which we call class B cases. The regional board's decision, if it enters into a bilateral agreement with the contractor, is final. If the contractor will not enter into agreement with the regional board, the latter issues a unilateral order. If the contractor wishes to appeal to the Renegotiation Board in those cases, a hearing is always granted. He must appeal within 90 days. If he should not appeal within 90 days and we wish to institute a hearing on our own initiative, we have that right. Most people, if they don't enter into agreement in the field, appeal

to the Renegotiation Board. In cases involving in excess of 800,000 dollars in renegotiable profits, the finding of a regional board is merely a recommendation. If the contractor agrees, it is embodied in an agreement, but it may not be signed by the chairman of that board until it is reviewed by the Renegotiation Board in Washington, so that a decision may be made whether or not the settlement is right.

Renegotiation must be commenced within one year after the filing of the contractor's statement, and the proceedings must be concluded within two years after the formal letter of commencement has been sent, unless at times extension agreements are entered into, just as in the case of tax returns, before the statutory period has run out.

Of the cases that come to us, the contractor's filings, roughly 10,000 a year, have been found to be above the statutory floor of 500,000 dollars. We call them statutory filings. Anyone with any amount of renegotiable business is called on under the law to file. We get something like 40,000 filings a year less than the statutory limit. We have provided, for use in such cases, a simple statement of nonapplicability, without going into detail on the costs and expenses--a streamlined approach. About 3,000 assignments are made to the field each year. After we get through what I call the Alpha stage, we come to the Omega stage, which is the exercise of judgment under the so-called statutory factors. They have become something like the Ten Commandments laid down by Moses.

The history of those statutory factors I think you may find interesting. As I said, in the 1942 Act the Congress merely described excessive profits as those which were found to be excessive under the terms of the Act. No criteria were established in the law. There was no war contracts board then, but the joint chairmen of the respective departments, namely the War Department, the Navy Department, the Maritime Commission, the War Shipping Administration, and the Treasury drew up in March 1943, I recall very well, criteria for the field offices to take into account in determining the existence or nonexistence of excessive profits, and the amount thereof. They drew up these seven factors--there were six, plus one. They then referred to them as seven. Now they speak of six. The seventh was what equity and fair dealing called for, laid down by the regulations of the Board. There has never been any specific implementation of it. It is one we attempt to apply in our judgment of the other six factors.

I think for the sake of the record I will read from the law those factors as they are now. Congress paid the joint chairmen the compliment

of writing them into the 1943 Act. They were written again into the 1948 Act, and also into the 1951 Act. With just minor variations in phrasing, they are essentially the same. Let me see if I can put my hands on them.

Here is the definition of excessive profits. "The term 'excessive profits' means the portion of the profits derived from contracts with the departments and subcontracts which is determined in accordance with this title to be excessive."

That is the way the first Act was phrased. From then on this has continued to be the definition. The first factor reads:

> "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; and in addition, there shall be taken into consideration the following factors:"

The first one is usually referred to as the efficiency factor.

"Reasonableness of costs and profits." I emphasize the fact that the regulation, the factor, and the law read "profits," not "prices." There has always been a great deal of discussion on that subject. The law reads:

> "(1) Reasonableness of costs and profits, with particular regard to volume of production, normal earnings, and comparison of war and peacetime products;
>
> "(2) The net worth, with particular regard to the amount and source of public and private capital employed;
>
> "(3) Extent of risk assumed, including the risk incident to reasonable pricing policies;
>
> "(4) 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;

"(5) Character of business, including source and nature of materials, complexity of manufacturing technique, character and extent of subcontracting, and rate of turnover;"

Finally, there is this overall one previously mentioned:

"(6) Such other factors the consideration of which the public interest and fair and equitable dealing may require, which factors shall be published in the regulations of the Board from time to time as adopted."

In connection with the net worth factor, I am going back to General Calhoun's introduction and the request in the letter that General Hollis sent me that I touch on the view taken in renegotiation of the use of Government facilities and equipment. That comes into consideration under the net worth factor. If any of you have had sufficient interest during the last 2 or 3 months to read comments from interested sources--most of them interested, rather than disinterested, I should say--about the alleged perversion of the net worth factor by the Renegotiation Board, there have been brochures published on it, articles in Aviation Week written by eminent counsel, and so forth. I have tried to treat these attacks very much as I recently learned President Lincoln decided he had to treat them, after the first year of the Civil War. I understand he tacked on his desk a statement reading: "If I took the time to read all the attacks on me, let alone answer them, I could do nothing in my shop."

We feel that there was so much misunderstanding resulting from these comments that only yesterday or the day before--this is very timely, gentlemen--the Board made a press release which I will read here for the record:

"STATEMENT ON NET WORTH FACTOR

"Because some misunderstanding apparently exists in certain quarters respecting the Renegotiation Board's interpretation and application of the so-called 'net worth factor' (Section 103(e)(2) of the Renegotiation Act of 1951, as amended), the Board today issued the following statement:

"Section 103(e)(2) of the Act provides that the Renegotiation Board shall, in determining excessive profits, take into consideration: 'The net worth, with particular regard to the amount

and source of public and private capital employed . . . .' In discharging its responsibility under this section, the Board does not regard any particular rate of return on net worth or capital employed as excessive per se. The Board does not attempt to equalize its determinations respecting the members of any given industry from the standpoint of return on net worth or capital employed, inasmuch as renegotiation obviously is not a rate-making process. The Board does not place special emphasis on the net worth and capital employed factor as distinguished from the other statutory factors.

"The Board desires to reemphasize the fact that reasonable profits are determined in every case by an overall evaluation of all the statutory factors, and not by the application of any fixed formula with respect to rate of profit on sales or rate of return on net worth or capital employed, or any other formula. That is not to say, however, that the return on net worth can properly be ignored in an appropriate case. Excluding those industries where capital is not a significant income-producing factor, the relationship of profit realized on renegotiable business to the capital and net worth employed in renegotiable business is, and properly should be, one of the considerations (though not the sole consideration) in the final determination of excessive profits. The Board's determinations must permit the retention of profits sufficient to provide a proper incentive for the investment of equity capital. Where borrowed capital is involved, the retained profits must reflect the additional risk to which equity capital is thereby subjected.

"With respect to contractors who receive Government financial assistance, the regulation under the 1951 Act (RBR 1460.11(4)) expresses a basic policy which was first enunciated under the 1943 Renegotiation Act (RR 412.2) and again under the 1948 Act (MRR 424.412-2(d)(1)): 'A contractor who is not dependent upon Government or customer financing of any type is entitled to more favorable consideration than a contractor who is largely dependent upon these sources of capital. When a large part of the capital employed is supplied by the Government or by customers, the contractor's contribution tends to become one of management only and the profit will be considered accordingly.'

"An example of the application of the foregoing policy is to be found in a case where an increase in Government-furnished facilities enables a contractor to achieve substantially expanded

volume for defense purposes. In such a case there will often be a significant increase in contractor's rate of return on net worth over the immediately preceding years, which generally will evidence in a concrete way the effect of increased volume and increased Government assistance. Certainly the Board must consider this fact, together with all other relevant factors, in determining whether contractor's profit on the expanded renegotiable sales bears a reasonable relationship to the expanded volume."

At this stage I see my time is running short. I have a statement here with regard to renegotiation which I think summarizes its salient aspects better than anything else I have ever seen. My attention happened to be called to it only recently. I missed it at the time the 1951 Act was before the Congress and our counsel called it to my attention recently. It was delivered by Mr. Carl Vinson, with whom you are probably all acquainted, the head of the Armed Services Committee of the House for so many years, at least when his party was in power, and, going back over the years, it has been in power more than the other side. Here is his statement:

"Renegotiation is not an exact science. There is no fixed formula or yardstick for the determination of excessive profits, nor is there any fixed maximum to the amount of profits which may be realized or retained by any contractor. . . . The bill lays down certain factors . . . which must be taken into consideration by the renegotiation authorities in determining in every case whether excessive profits exist, and if so, in what amount. . . .

". . . I think it important to emphasize before this body that renegotiation is an operation which is broadly conceived and broadly administered. It is not a detailed process of audit and examination, contract by contract and dollar by dollar. And it is by no means a device to remedy or repair errors on inequities in individual procurement transactions. The renegotiation authorities do not reset the price of each contract after completion of performance and payment. This type of individual price adjustment, which was contemplated in the earliest days of renegotiation and from which the process derived its name, gave way almost immediately, out of obvious necessity, to overall review of a contractor's operations for his entire fiscal year.

"This basic conception is indispensable to any understanding of what renegotiation is and the way it works. All of a contractor's receipts or accruals during his year from all of his contracts and subcontracts subject to renegotiation, including both his profitable and his nonprofitable ones, and all of his costs and expenses applicable thereto, are considered at a single time in a single proceeding together with all other facts and figures pertinent to the statutory factors, and a single overall determination is made. If no excessive profits are found to exist, a clearance is granted to the contractor. If it is determined that excessive profits were realized, a determination of the amount thereof is made and this determination is embodied in an agreement or order.

"It is evident that in this type of operation the renegotiation authorities must use, not a fine-toothed comb, but a broad brush. And it is for precisely this reason that renegotiation is not designed to be, nor can it be, a substitute for sound procurement pricing. Renegotiation does no more than prevent or eliminate profits that are clearly excessive and unreasonable on an overall 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. . . . The purpose is not to take money away from the contractor, but rather to see that not too much money has been taken from the Government under unusual conditions lacking the controls normally exerted upon prices by the pressures of competition."

With this I stop.

MR. MUNCY: Gentlemen, Mr. Coggeshall is ready for your questions.

QUESTION: Mr. Coggeshall, we have had a good many representatives of industry and industrialists appear here with us and they have one common consensus that the continuation of renegotiation at this time is "legalized confiscation." They claim that, if we return to a free play of competition, that that in itself would drive down excessive profits, that the Government would get better products from this competition, and that this would allow the continued growth of the economy which has made this country great. Would you care to comment on that?

MR. COGGESHALL: That is rather a mouthful, as I think John Hylan is quoted as having said to the Queen of Roumania when she was visiting New York, "Quite a mouthful, Queen." From the beginning of renegotiation similar remarks have been made, and all the time the Act has been in existence. The first Act had to be amended in the fall of 1942, as stated earlier, and when it came time for a new Act in 1943, the same statements were made, with a great deal of heat. They were made after the 1948 Act was passed without any open hearings. During the legislative discussion of the 1951 Act, similar statements were made, as I would have mentioned in the section of my outline which I skipped out of consideration for the gentlemen in this audience. I have heard the same statements made by people when I attended various sessions last fall at the invitation of Mr. Stam, the head of the staff of the Joint Committee on Internal Revenue and Taxation. Congress, in extending the 1951 Act for two years, at the request of the President, last year provided for a study to be made by that Committee whether or not Renegotiation should be extended beyond 31 December 1956.

All interested industry groups who asked for a session with the Joint Committee on Taxation by 30 September 1955, were permitted to have such a session with Mr. Stam and his staff. Representatives of the Defense Department and of all three military services, Army, Navy, and Air Force, and also the renegotiation authorities, were invited. I attended all but one of those meetings with counsel.

My view, and I will state right here, our view on the Board, our official view, is that we administer an Act. We are neither advocates of nor antagonists against the extension of the Act. We go on the basis that in the first instance there has to be a decision as to whether or not it is necessary. This committee was asked to make a study, and their report must be made to the Congress by 31 May of this year. Hearings were held. At these hearings--not exactly hearings, but executive sessions, at which the National Association of Manufacturers, the U. S. Chamber of Commerce, NSIA, MAPI, the Machine Tool Builders Association--I hope I haven't forgotten anybody--there were a half dozen, at least--attended, and I was asked to participate--I told Mr. Stam I would be very happy to accept an invitation to attend, but I would not participate beyond the point of making observations from time to time as seemed proper to clear up any misunderstandings or any inadvertent misrepresentations that might be made with regard to the administration of the Act.

I was asked my views and I said I was neutral. I was asked what I meant by "Neutral." I said, "I remember a story I heard some years

ago of a mountaineer in Tennessee who told one of his friends, 'You know, when I came home last night to the cabin I found my old woman rassling with a b'ar.' The friend asked, 'What did you do?' He said, 'I was neutral.' The friend said, 'What do you mean?' He replied, 'I said, "Go it, old woman! Go it, b'ar!"'"

The representatives of industry all advanced reasons why renegotiation is a terrible interference with private enterprise, and that it would be much better if everything was left to competition, and so forth; but they always ended up, "Well, now, of course, if your committee recommends that renegotiation not be extended, of course we expect you to recommend also that the Vinson-Trammel Act be suspended, and the Maritime Act, etc., be suspended."

Mr. Stam would ask quietly from time to time, "If you can't have them all suspended, and other profit limitation laws would come into effect when renegotiation would no longer be in effect, what would be your preference?" They invariably ended up by saying, "We would rather have Renegotiation."

There were other justifications for extension. The President said in his message that he wanted it for at least two years, to be passed as part of his defense budget, and, so long as more than half of the budget went to defense, he felt that renegotiation should be continued.

If you take that as a proper point of departure, and I think it is rather difficult not to, so long as anything like more than half of the taxpayer's dollar--your dollar, my dollar, and everybody's here--50 cents of every dollar we pay Uncle Sam--goes to defense--and the taxpayer has nothing to say in regard to how that part of his dollar is spent--nothing whatsoever--Congress is not only justified, but has an obligation to see that the profits realized--not just the price, but the profits realized--on this business that is peculiar either to a war or something next door to war, cold-war defense--the reasonableness of those profits--should be reviewed.

It is not an easy job. Nobody would ask for it--nobody in his right senses. Secretary Sharp of the Air Force a week or so ago said to me, "You fellows must have a terrible job. I don't know how you people make up your minds." I said, "I know what my wife told me. She said I was crazy to go back to Washington in 1949. I suppose perhaps I was." One of my younger colleagues said once, "You don't <u>have</u> to be crazy to be in renegotiation, but it <u>helps</u> a lot!"

QUESTION: Mr. Coggeshall, I believe that one of the specific objections voiced by industry insofar as renegotiation is concerned is the fact that it takes 2 to 3 years' time before your Boards come around to review the contracts for a particular company for a particular fiscal year's business. That has been brought out as an objection recently by the Boeing Company and the Temco Airplane Company, wherein you have ruled that excessive profits refunds are due from those companies for their fiscal year business in 1952, four years ago. I find myself somewhat sympathetic with this position as voiced by industry. I don't see how they can operate their financial affairs in an efficient manner when they don't know until 2, 3, or 4 years later just exactly what their net profit was for that particular fiscal year. Would you comment on that?

MR. COGGESHALL: Yes, there is some merit to the argument, to the extent that it exists. It is not at all universal. We make, as I mentioned, about 3,000 assignments to the field annually. We happen to have open assignments of less than 3,000 today. We have about a year's backlog. Contractor's filings are not made until the beginning of the fifth month after the close of a contractor's year. For a calendar-year company the filing is made 1 May. It is examined to see if it is sufficiently complete to be sent to the field. It then goes through a screening committee. Generally speaking, an assignment goes out within two months of when it is made.

There has been a great deal of difficulty. It did not originate with us. It originated with the Congress, in getting the 1951 Act under way. The Act was not passed in the first instance, or signed by the President, until 23 March 1951, and then no Board was appointed for several months. He sent no nominations to the Senate until September of that year, 1951. The Senate did not approve the appointments until 2 October 1951. They took office 3 October 1951.

The first job they had to do was draw up regulations for the 1951 Act. In drawing up regulations they gave industry every opportunity to pass on the proposed regulations. They had hearings for each of the industrial associations, just as we are going on up at the Hill now in connection with the Joint Committee report. It was not until the middle of 1952--my recollection is that it was maybe June or July--that the regulations were published in an approved form and approved by the Bureau of the Budget, and therefore there were no filings made for the 1951 year until the latter part of 1952.

Now, the Board started away behind. We have done our best to catch up. We are getting increasingly current. Two years ago the open assignments passed 6,000. The open assignments today are less than 3,000. We have about a year's backlog in the field. The total 1951 assignments were over 6,000. There are less than 100 open for that year, most of them representing late and delinquent filings made by contractors.

This responsibility also rests with the contractors, as well as with the Congress. I am not saying we are perfect either. But we received 165 assignments this year which had to go to the field, for the 1951 year. They are still coming in for 1951.

On the 1952 assignments, the 1952 year contractors are more than 90 percent completed. The 1953 year contractors are, roughly, 67 percent completed. The 1954 contractors are approximately 25 percent completed.

Of those filed, for the fiscal year 1955, something like 5 percent are already completed. We are doing our best. I recognize, and my associates recognize, the importance of it. We exert constant pressure on our field offices to get as current as possible. We have some cases which become very much involved. Some require special coordination. When you examine the picture of some of the airplane companies, it is a peculiarly complicated job. We examine the results of groups of contracts. We just don't throw everything together, the result of CPFF contracts, incentive contracts, redeterminable, straight fixed price, etc. Those are grouped and the results under these groupings must be examined before we can reach a fair determination on an overall basis.

There must be a large number of officers in this group who have had experience with procurement. You know that on redeterminable contracts the determination of profits on an incentive-type job, peculiarly, may be one or two years beyond the performance stage. We can't get our work properly under way, let alone completed, until procurement has determined--until they have come to a final price on an incentive job, and in other redeterminable contracts. Those are always going to be somewhat behind.

QUESTION: One of the main objections raised to renegotiation is that it is said to penalize efficiency. I would like to know something

more about the way you treat this question of efficiency. Let me be a little bit more specific, by way of a hypothetical example, which I assume is not too unusual. Suppose a company, in undertaking a substantial contract over a period of time, in the course of a month installs some new technology or organization which cuts its costs substantially over the period of time, more than was anticipated at the beginning of the contract. Would you be inclined to let them have all the savings made, or do you feel that the same should accrue to the Government?

MR. COGGESHALL: I can't give a specific answer in any one case without a full knowledge of all the pertinent facts. The efficiency factor is studied most carefully by us. We recognize a definite obligation, I mean, to see that a more efficient producer fares better in renegotiation than a less efficient producer, to the extent they are both found to realize excessive profits. In many cases the less efficient people don't realize any profits, or obtain such low profits that the question of excessiveness is nonexistent. That's all there is to it. I always tell people when they argue that we haven't recognized their efficiency and ask, "Don't you recognize how efficient we are?", "Of course we do. You probably wouldn't be here unless you were efficient. It is generally the cream of American industry that comes here."

We can't take the contractor's own self-serving statements as gospel truth. He gives us the lead, and we turn to procurement for verification. We continue to have close liaison with them, though we are no longer officially connected. Therefore, when it comes to checking efficiency, we get procurement reports. If there seems to be a wide discrepancy and disparity between contractors' statements and procurement reporting, we undertake to explore that disparity and find out what the true picture is. Usually it turns out that the truth lies somewhere between a contractor's self-serving representations and perhaps the jaundiced eye of a procurement officer.

We do our best to see that efficiency is recognized in our findings. I think I can say that the more efficient producers, generally speaking, find that it is recognized in renegotiation settlements.

That does not mean to say that there may not be a finding of excessive profits in such cases, but, our determinations of excessive profits are never penalties. Renegotiation is not a process of imposing penalties. We find, generally speaking, that inefficiency produces its own penalty. I mean, the inefficient fellow often ends up with a loss of 2 percent, 3 percent, or 4 percent on his sales, or more.

GENERAL HOLLIS: I would like to make an observation, rather than ask a question, if I may, and speak to the colonel in conjunction with his question.

MR. COGGESHALL: Yes, sir.

GENERAL HOLLIS: Because you have a job that does not make you friends, particularly in this wide field that he referred to, and because you mentioned the lag in price redetermination, I would like to cite an incident or two. One of the hardest jobs I had as a procurement chief was trying to whip my people into cleaning up price redetermination cases which were getting scandalously old and revolted me every time I looked at the box score. That wasn't easy. It was not because they had been indifferent to the case. In many instances, it was because the firm itself insisted that it was virtuous, and wanted to dig up new items.

There was one instance, the most flagrant one, perhaps, wherein the costs cited were not only the hotel bills of the president and those of his wife, when the president went to New York on a Government contract, but also included the cost of the superintendent or caretaker of the president's country home in its proportionate share for a Government cost on this thing. The firm happened to have gotten an exorbitant price, a grossly exorbitant price--even they admitted that--on the end item when it was awarded, and they had some quarter of a million dollars of Uncle's money, interest free, and the firm was not at all eager, just in terms of time, to resolve this question, unless they could resolve it totally in their own interest.

We didn't put that one in shape for Mr. Coggeshall's outfit to get at it for--I am not proud of this--2-1/2 years. So I thought that was relevant to his recitation on the subject, and took the liberty to say it.

MR. COGGESHALL: Very definitely, General, it is much appreciated. I will say on the renegotiation side that we have seen, not necessarily as a consequence of, but at least following, a ruling of the Treasury made in March or April of 1953, certain interesting developments. When I was out at Wright Field at that time having a visit with General Farnsworth, who was with us in Air Force renegotiation for a time during the war, who succeeded General Phil Smith in procurement, and who is now Air Force Auditor General, as you know, General Farnsworth told me one day after lunch, "We had a terrible thing happen." I said, "What?" He replied, "Such-and-such

Company--it would be that company--when we asked for a redetermination refund of a million and one-half dollars applicable to a prior year, replied that they were first going to apply for Federal tax credit. They were asked how they got that way. They said they had read Section 3806 of the Internal Revenue Code and found they were entitled to apply for tax credit in redetermination proceedings just the same as they would be in renegotiation. I said, 'It has never been done that way.' So they wrote to the Treasury and the Treasury gave them a ruling to that effect, and published the ruling." General Farnsworth added, "What do you think of that?" I said, "Do you expect me to break down and weep, Bill? This has been a great source of trouble to us in renegotiation, trying to get current. I know you. You are going to tell your boys from now on to see that their redetermination is complete in whatever way it can be, or they have to give you the reason why, before the contractor files his tax return for that year. Am I right?" He said, "You bet your bottom dollar you are right." We have seen far less drag in determination since that ruling was published three years ago than prior thereto.

MR. MUNCY: Mr. Coggeshall, we are indeed thankful to you this morning for a very helpful statement on the trying problems of renegotiation. You have been very good to come here and give us your time and to answer as completely as you have our real stickler questions.

MR. COGGESHALL: I appreciate the opportunity very much. I thank you all.

(29 Mar 1956--250)O/feb