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REPORT TO THE SUBCOMMITTEE  
ON PRIORITIES AND ECONOMY  
IN GOVERNMENT  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES

24728

72-0353

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RELEASED

Use Of Government-Owned  
Equipment By Certain Large  
Contractors On Commercial  
And Defense Work B-140389

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Department of Defense



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BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES

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JUN 1 1970



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-140389

Dear Mr. Chairman:

This is our report in reply to your request of April 29, 1971, that we examine into statements by representatives of the National Tool, Die and Precision Machining Association that large defense contractors using Government-owned equipment have an advantage over smaller contractors in competing for commercial and defense work.

As agreed with your office, we have not followed our usual practice of obtaining written comments from the agency and the contractors involved. We will not distribute this report further unless copies are requested and we obtain your agreement or unless you publicly announce its contents.

Sincerely yours,

Comptroller General  
of the United States

*C1 + R*  
The Honorable William Proxmire  
Chairman, Subcommittee on Priorities  
and Economy in Government  
Joint Economic Committee  
Congress of the United States

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ABBREVIATIONS

ASPR      Armed Services Procurement Regulation  
GAO      General Accounting Office  
GE      General Electric Company  
IPE      industrial plant equipment

COMPTROLLER GENERAL'S  
REPORT TO THE SUBCOMMITTEE  
ON PRIORITIES AND ECONOMY  
IN GOVERNMENT  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES

USE OF GOVERNMENT-OWNED EQUIPMENT  
BY CERTAIN LARGE CONTRACTORS  
ON COMMERCIAL AND DEFENSE WORK  
Department of Defense B-140389 5

D I G E S T

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WHY THE REVIEW WAS MADE

On April 28, 1971, representatives of the National Tool, Die and Precision Machining Association testified before the Joint Economic Committee's Subcommittee on Priorities and Economy in Government. They cited 14 examples in which contracts had been awarded to large defense contractors that used Government-owned industrial plant equipment to perform tooling and production work which the representatives said could have been done more economically by small tool contractors if truly competitive conditions had prevailed.

The representatives said that use of such equipment gave large contractors a competitive advantage because the rent they paid the Government was less than the cost of private ownership incurred by the small tool contractors. The representatives said also that large contractors had virtually a blanket authorization to use the equipment for any commercial or Government program. The Chairman of the Subcommittee requested that the General Accounting Office (GAO) investigate the matter.

Department of Defense policy and practice

The Department of Defense policy is to remove Government-owned equipment from contractors' plants when the equipment no longer is needed. The question of retention of Government-owned equipment at contractors' plants is being covered in depth in another review, and the results will be included in a forthcoming report. (See p. 5.)

When retention is allowed contractors usually are permitted to use the equipment for commercial work if they obtain advance written authorization. Generally the equipment is used rent-free on Government work, but rent is charged for commercial use by the following method.

The cost of the equipment is multiplied by percentage rates prescribed in the Armed Services Procurement Regulation (ASPR) for the age of equipment to determine the gross rent. The percentage of contractor effort on Government work (based on direct labor hours, sales, machine hours, or other equitable measures) is applied against the gross rent to arrive at the rent charged for commercial use. (See p. 4.)

Charging rent for commercial use is intended to equalize competition for commercial work. To evaluate competing bids for Government work, the bids of contractors having rent-free use of Government-owned equipment are increased by the rental value assigned to the equipment. (See p. 4.)

The association's 14 examples included 12 in which the contractors had performed commercial tooling work and two in which Government work had been involved. The amounts and periods of performance of some differed from the data given in the testimony. Also one award mentioned in the testimony had not been made. One similar in many respects to those cited by the association was added in its place. (See p. 6.)

Commercial work

In all 12 examples the contractors used Government-owned equipment in the performance of their commercial work. In eight of the examples, it appeared that the equipment was used without proper authorization, and, in two of the examples, the method used to compute the rent credit was disadvantageous to the Government. (See p. 6.)

GAO could not determine whether the use of Government-owned equipment gave the contractors a competitive advantage because ASPR did not require, nor did the contractors maintain, machine-use records. Such records would have identified the specific Government machines and the number of machine hours used to fabricate commercial tooling. Without these records GAO could not determine the costs of renting the equipment from the Government and thus could not compare the costs of renting with the costs of private ownership. (See p. 6.)

In seven examples contractors were awarded the tooling orders because they had the capacity to absorb the large numbers of machining hours required and had the skills needed to design and test the tools. It was not feasible to determine the extent to which the availability of large amounts of Government-owned equipment contributed to the contractors' capacity and skills.

GAO believes, however, that a contractor with large amounts of Government-owned equipment often benefits in that it can solicit defense and commercial work without the need for additional capital investment. (See p. 7.)

Government work

In the two examples involving Government work, the contractors had authorization to use Government-owned property on a rent-free basis. Such usage, however, was not the determining factor in their winning the awards. (See p. 19.)

RECOMMENDATIONS OR SUGGESTIONS

A forthcoming report to the Congress will include recommendations to the Secretary of Defense for establishing a uniform and equitable method of computing rent and for improving controls of Government-owned plant equipment in the custody of contractors. (See p. 5.)

## CHAPTER 1

### INTRODUCTION

During testimony on April 29, 1971, the Chairman of the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee asked the General Accounting Office to examine into statements made during testimony on the previous day by representatives of the National Tool, Die and Precision Machining Association. The association claimed that the Government allowed large defense contractors to enjoy a competitive advantage over small contractors by permitting the large contractors to use billions of dollars worth of Government-owned industrial plant equipment (IPE) on commercial and Government work.

A competitive advantage exists, according to the association, because the rent paid by contractors for the use of Government-owned IPE is far less than the cost of ownership or commercial lease. Most IPE consists of standard general-purpose machine tools--the same type purchased privately by association firms. The association also said that these large contractors have virtually a blanket authorization to use the equipment for any commercial or Government program. These conditions, the association claimed, have caused small contractors to lose a large segment of their traditional markets to large defense contractors.

The association cited 12 examples in which large contractors allegedly had used Government-owned IPE and other types of property for machining and tooling work on commercial aerospace programs, which small contractors could have performed more economically if truly competitive conditions had prevailed. Also mentioned were two examples of small contractors competing unsuccessfully for defense work against large contractors having Government-owned equipment. Excerpts from the association's testimony concerning the 14 examples appear in appendix I.

## REVIEW OBJECTIVES

We conducted our review at each of the contractor locations mentioned in the testimony to determine whether the contractors

- had used Government-owned equipment on the orders,
- had enjoyed a competitive advantage because of any such use, and
- had received authorization and had paid rent for any such usage in accordance with the applicable regulations.

## DEPARTMENT OF DEFENSE POLICY

The policies concerning a contractor's use of Government-owned property are set forth in ASPR section 13 and in the appropriate contract clauses in section 7. ASPR appendix B, 603.1, states that contractors must report to the Government contracting officers all items of IPE for which retention is not justified. When retention is allowed contractors are permitted generally to use the equipment for their commercial work if they obtain advance written authorization. Also special permission is required in advance if IPE is to be used commercially over 25 percent of the time it is available for use.

Generally the equipment is used rent-free on Government work, but contractors are charged rent for commercial use by the following method. The acquisition cost of the equipment is multiplied by rental rates prescribed in ASPR 7-702.12 for the age of equipment to determine the gross rent. The percentage of contractor effort on Government work (based on direct labor hours, sales, machine hours, or other equitable measures) is applied against the gross rent to arrive at the rent charged for commercial use.

Charging rent for commercial use is intended to equalize competition for commercial work. For Government work ASPR 13-501 requires that, to evaluate competing bids, the bids of contractors having rent-free use of Government equipment be increased by the rental value assigned to the equipment.

## RELATED GAO REVIEWS

In November 1967 GAO reported to the Congress (B-140389) that there was a need for improvements in controls over Government-owned property in contractors' plants. Our findings indicated that:

- Equipment was being used without proper authorization.
- Contractors' records did not reflect adequately the extent and manner of use.
- Equipment with little or no use was being retained, although some was needed for defense work at other locations.
- A lack of uniformity in the methods used to compute rent was resulting, in some cases, in inequitable rental payments.

Currently we are making a follow-up review of these matters. Our preliminary findings indicate that there is a need for further improvements in all of these areas. The forthcoming report to the Congress will contain specific recommendations to the Secretary of Defense on these matters.

## CHAPTER 2

### USE OF GOVERNMENT PROPERTY ON COMMERCIAL WORK

The association's 12 examples of large defense contractors using Government-owned property on commercial tooling orders included:

- Five examples in which North American Rockwell Corporation had received tooling orders from other large contractors.
- Three examples in which large contractors had received tooling orders from McDonnell-Douglas Corporation.
- Four examples concerning Lockheed Aircraft Corporation; two involved work performed in-house, and two involved tooling orders awarded to other large contractors.

We found that the aircraft programs involved and the values and periods of performance differed from the data given in the association's statements. We deleted one of the McDonnell-Douglas awards from our examination because it had not been made. We substantiated, however, that the major aerospace contractors in the 11 remaining examples cited had used Government-owned equipment in the performance of their commercial work.

Government-owned equipment also was used in commercial work awarded by Lockheed to North American; this award was not cited by the association but was added to our review because it was similar in many respects to the above examples. In two examples we found that the method used to compute rent was disadvantageous to the Government, and in eight examples it appeared that Government-owned equipment was used without proper authorization.

We could not determine if the use of Government-owned equipment gave the contractors a competitive advantage because they did not maintain use records which would identify the specific Government machines or the number of machine hours used to fabricate commercial tooling.

In most cases rent was computed on the basis of direct labor hours. This method, which is permitted by ASPR 7-702.12, provides for estimating the direct-labor-hour ratio of Government work to the total direct labor hours for all the contractor work. This percentage is used to compute the rent credit to reduce the gross rent. Use records for each machine are not required to estimate direct labor hours. Without adequate use records we could not determine which items of equipment were used for the tooling awards cited, and consequently we could not make a comparison of rental costs with ownership costs.

In seven examples large contractors were selected because they had the capacity to absorb the large numbers of machining hours which were required in a short time and had the skills needed to design and test the tools. It was not feasible to determine the extent to which the availability of large amounts of Government-owned equipment contributed to the contractors' possession of the requisite capacity and skills.

The five other examples included:

- One example in which the receiving contractor had been the only acceptable bidder.
- Two examples in which the awarding contractors refused to discuss why they chose a large contractor.
- Two examples in which the work had been performed in-house.

We believe, however, that a contractor with large amounts of Government-owned equipment often benefits in that it can solicit defense and commercial work without the need for additional capital investment.

A schedule of the contractors included in the review, the values of the orders received, the rents paid, and the acquisition costs of Government-owned property in their custody as of June 30, 1971, is shown as appendix II.

AWARDS TO NORTH AMERICAN ROCKWELL CORPORATION

According to association testimony North American Rockwell Corporation received commercial tooling orders worth about \$19.5 million from five large defense contractors during 1970 and 1971. As we indicate below, however, the orders took place in an earlier period and the value of the awards totaled \$60.4 million. We identified an additional award of \$1.9 million received by North American from Lockheed-California Company for commercial tooling and included it in our review. The amounts and time periods of the orders are as follows:

<u>Contractor</u>	<u>Time period</u>	<u>Program</u>	<u>Value of award (000 omitted)</u>
Aeronca, Inc., Aerocal Division	1969-70	Lockheed L-1011	\$ 215
Goodyear Aerospace Corp., Arizona Division	1966-69	Boeing 747	6,500
Boeing Company	1965-69	Boeing 727, 737, and 747	25,565
McDonnell-Douglas Corporation	1964-68	DC-8 and 9	15,202
Northrop Corporation, Norair Division	1967-68	Boeing 747	<u>12,929</u>
Total			60,411
Lockheed-California Company	1968-70	L-1011	<u>1,918</u>
Total			<u>\$62,329</u>

Generally the orders involved planning, designing, fabricating, and testing the tools. Goodyear, Northrop, and Lockheed selected North American because:

--Large amounts of machining hours were required in short periods of time.

--The orders required tool-planning and tool-designing expertise, special facilities to handle big tools, and computer processing systems.

--Administrative problems would occur if numerous small firms were used.

Aeronca officials stated that they had chosen North American because it was the only acceptable bidder. Boeing refused to discuss the selection because the contracts had been for commercial programs. McDonnell-Douglas refused to discuss awards made so long ago.

North American had authorization to use Government-owned IPE on commercial programs during the period 1965-69. During 1971 the contractor had about \$19 million worth of Government-owned machinery and equipment, including about \$1 million worth in the tooling department. The tooling department also had about \$2.6 million worth of contractor-owned equipment.

We could not determine how much Government-owned IPE was used on the orders because North American did not keep machine-use records adequate for this purpose. From other records it appeared that the majority of the machining work was performed on Government-owned IPE and that some of the equipment was used commercially over 25 percent of the time it was available for use. Although they had permission to use the equipment for commercial work, they did not comply with the requirement in ASPR 13-405 that advance approval be obtained from the Secretary of the department concerned, or, in some cases, from the Office of Emergency Preparedness, for commercial use in excess of 25 percent until fiscal year 1970.

Rent paid from March 1966 to September 1970 for use of Government-owned IPE in all departments totaled \$3.9 million. North American officials stated that rent on these orders totaled about \$959,000. We could not verify this amount because equipment-utilization records showed total hours used but not the amount of use of Government-owned IPE on commercial programs. Generally North American computed its rents in accordance with the provisions of ASPR.

MCDONNELL-DOUGLAS CORPORATION AWARDS  
TO LARGE DEFENSE CONTRACTORS

Association testimony indicated that the following four contractors had received tooling orders from McDonnell-Douglas Corporation during 1970 and 1971.

<u>Contractor</u>	<u>Aircraft program</u>	<u>Value of award (000,000 omitted)</u>
Aeronca, Inc.	DC-10	Over \$3
Convair Aerospace Division, General Dynamics Corporation	DC-10	\$5
North American Rockwell Corporation (note a)	DC-8	\$4
Rohr Corporation	DC-10	(b)

<sup>a</sup>Discussed on pp. 8 and 9.

<sup>b</sup>Value not stated.

The information we developed indicated that:

- Aeronca bid on a \$3 million DC-10 tooling order but, according to corporation officials, was not awarded the contract.
- The award to Convair involved a contract for more than \$500 million for the production of DC-10 fuselages, and it included the design and fabrication of the necessary tooling valued at \$45 million. Convair started the tooling work late in 1968.
- Rohr's contract on the DC-10 was for the production of the engine pods and included the design and fabrication of the tooling needed in production. Rohr started using Government-owned IPE on the tooling in March 1969.

The association stated that Rohr had sent some of its DC-10 tooling work from its main plant at Chula Vista, California, to its leased facilities in Riverside, California. Rohr officials justified the transfer by stating that

it was their policy to manufacture tooling in-house whenever possible. We found that the Riverside plant was not leased but was owned by Rohr, as evidenced by their property tax bill.

The DC-10 orders cited by the association had not been awarded to small contractors, according to McDonnell-Douglas officials, because:

- The orders were package procurements--the supplier had to design and fabricate the tooling and manufacture the part.
- Douglas was not able to coordinate and manage a subcontracting effort using many small suppliers.
- The large DC-10 contractors were not reimbursed until they delivered the parts to McDonnell and small business would not have been able to accept this arrangement.

McDonnell-Douglas officials said, however, that small contractors had received 2,896 of the 3,750 tooling orders awarded on the DC-10 during the period from January 1969 to July 1971. The orders included production of machine tools and tool and die fixtures for portions of the aircraft fabricated at various McDonnell-Douglas plants.

Convair officials stated that through June 1971 they had used 13,000 machine hours on Government-owned IPE for producing both tooling and aircraft parts. Their records do not identify the machines used or the number of machine hours expended on the production of tooling alone. The records at Rohr also are of limited value for identifying machine utilization. A company official estimated that Rohr had used Government-owned IPE for 12,000 machine hours on DC-10 tooling and estimated that Rohr had paid \$18,000 in rent for these hours.

In both situations the companies had authorization to use the Government-owned IPE on commercial work. They computed rent on the basis of machine hours. It was not possible, however, to relate the rent paid to the DC-10 tooling work. We did test their rental computations, however, and confirmed that they were developed in accordance with the ASPR provisions.

LOCKHEED AIRCRAFT CORPORATION AWARDS TO  
LARGE CONTRACTORS AND IN-HOUSE ORGANIZATIONS

Association testimony

The association representatives testified that Lockheed Aircraft Corporation had used Government-owned IPE on tooling work for its commercial L-1011 aircraft in Government-owned, contractor-operated facilities at Van Nuys, California, and Marietta, Georgia. According to the representatives:

- Lockheed awarded L-1011 tooling orders, which were performed with Government facilities, to the Martin-Marietta Corporation and the LTV Aerospace Corporation.
- LTV's orders, worth \$3 million to \$5 million, were negotiated to include a composite rate of \$0.31 per hour for the use of Government-owned IPE, whereas a firm using its own would normally charge about \$4 per hour.

Lockheed-California

The L-1011 is produced by Lockheed-California Company, a division of Lockheed Aircraft Corporation, at facilities in Burbank and Palmdale, California. Tooling fabrication began in June 1968 and is being performed in four buildings at Burbank, two of which are Government-owned, and in a Lockheed-owned plant at Palmdale. Lockheed-California officials advised us that Government-owned plant equipment at the Van Nuys facilities (owned by the city of Los Angeles, California) was used exclusively for a military helicopter program. Navy plant representatives confirmed Lockheed's statement.

As of August 1968 Government facilities costing about \$40 million were at Lockheed-California. On April 21, 1970, the General Services Administration agreed to sell nearly all of these facilities to Lockheed for about \$30 million. The price was based on an independent property appraisal performed on November 30, 1968. Passage of title is awaiting clearance by the Department of Justice.

We could not determine the extent to which Government-owned IPE was used on L-1011 tooling because machine-use records were not retained. From June 1, 1968, to April 21, 1970, Lockheed-California paid the Government about \$2 million for commercial use of Government facilities. According to Lockheed officials, about \$1.9 million of the rent was for the L-1011 program. This included about \$285,000 for tooling.

From our limited review it appears that the rent computations--which were based on direct labor hours--were in accordance with ASPR through April 21, 1970. Since then, under an agreement with the General Services Administration, Lockheed-California has been incurring a fixed daily possession fee of about \$5,000, payable over and above the selling price when title to the property is conveyed. The accrued fee was about \$3.3 million at the end of January 1972. If the sale is not made, rent for this period will be recomputed using the ASPR rates.

Lockheed-California used Government facilities on the L-1011 for over a year without advance written authorization as required by the ASPR clause in its facilities contracts. Contractor and Department of Defense officials agreed that the requirement for written authorization was overlooked but pointed out that there was full knowledge of the rental payments, indicating apparent Government permission for the usage.

#### Lockheed-Georgia

Lockheed-Georgia Company began work on the L-1011 program in April 1968. Lockheed-Georgia designs, fabricates, and assembles the tail section in a Government-owned, contractor-operated plant at Marietta and in privately leased plants at Charleston, South Carolina; Chattanooga, Tennessee; and Meridian, Mississippi. Meridian was the only plant not having Government equipment during L-1011 production.

The work cited by the association consisted of 7,596 tooling orders for the L-1011's fuselage, which required about 232,000 direct labor hours and represented about \$3 million in sales. The work, which originally was to be

performed at Lockheed-California, was transferred to Lockheed-Georgia's Marietta plant during the period October 1969 through May 1971 because Marietta's tooling departments had excess capacity and California's were overloaded. The transfer prevented a layoff at Marietta. Small tool and die firms could have completed the orders, according to Lockheed-Georgia officials, because Lockheed-California had performed most of the tool design and had enclosed, with each order, a blueprint of the tool and the part it produced.

Three tooling departments performed 95 percent of the orders. On August 31, 1971, these three departments had 239 pieces of IPE, costing about \$4 million, of which 161 pieces, costing \$3.4 million, were Government owned. Because Lockheed-Georgia does not maintain usage records on each piece of equipment, there is no way to determine the extent to which Government machines were used on the tooling orders of the L-1011 program. A Lockheed-Georgia official stated it was his company's policy to use its own equipment, if available, on commercial work.

From January 1968 to July 1971, Lockheed-Georgia paid about \$981,000 in rent for commercial use of Government facilities at five of its plants. About \$587,000, including about \$39,000 for the tooling orders, was attributable to the L-1011 program. According to Department of Defense records, Government facilities costing about \$145 million were at Marietta as of June 30, 1971. Lockheed-Georgia computed rent using the rental formula in ASPR. On the basis of our test, however, the rental payments appeared to be unreasonably low because the methods used to estimate Government and commercial usage--direct labor hours and square footage--were not refined sufficiently or were inequitable.

For March 1971 we recomputed the rent due for personal property by allocating direct labor hours, between Government and commercial work, at a lower organization level (burden center) than did Lockheed. We recomputed also the rent due on real property on the basis of a direct-labor-hour allocation. The contractor classified the space associated with the real property as Government, commercial, or joint use. The gross rent for the month was allocated to the Government and Lockheed by a "sharing ration" which is the ratio of Government to commercial square footage. Joint space was allocated in the same sharing ration.

On the basis of our review of the contractor's operations, however, it appeared that joint space was being used more extensively for commercial purposes than was indicated by the sharing ration. We feel that it would be more equitable to compute rent for real property on the basis of a direct-labor-hour allocation. A comparison of our rent computations and the amounts actually paid by Lockheed for commercial use in March follows:

	<u>Personal property</u>	<u>Real property</u>	<u>Total</u>
GAO computations	\$17,099	\$12,608	\$29,707
Paid by Lockheed	<u>10,681</u>	<u>1,892</u>	<u>12,573</u>
Difference	<u>\$ 6,418</u>	<u>\$10,716</u>	<u>\$17,134</u>

Lockheed-Georgia used Government-owned IPE on the L-1011 program for over half of the production period without obtaining the renewed written authorization required by ASPR 13-405. The contractor periodically informed the Government contracting officers, in a statement accompanying the rental payments, that Government facilities were being used on the L-1011. The contracting officers stated that the requirement for written authorization was overlooked.

We plan to issue a report to the Secretary of the Air Force, the service primarily involved, informing him of these and other deficiencies in the contract administration at Lockheed-Georgia.

Tooling orders on the L-1011

Lockheed-California awarded \$21.7 million in tooling orders, as follows:

<u>Source</u>	<u>Value of orders (millions)</u>
Large business--4 firms	\$ 7.7
Small business--56 firms	<u>14.0</u>
Total	<u>\$21.7</u>

The orders for \$7.7 million in tooling work were awarded to LTV Aerospace, Martin-Marietta, North American Rockwell,<sup>1</sup> and the Boeing Company's Wichita Division which we excluded from the review because its award was for less than a half million dollars. Lockheed selected these firms because:

- Most of the work was needed in a short period of time.
- The orders were for entire segments of the aircraft.
- The contractors generally were required to plan, design, and test the tools.
- Using many small firms would have created administrative, scheduling, and engineering problems.
- Small firms would have had to sublet part of the work.

#### LTV Aerospace Corporation

The L-1011 orders to LTV required about 72,000 tool fabrication hours and, according to LTV officials, represented about \$1 million in sales. The orders were performed at the Michigan Army Plant--a Government-owned, contractor-operated facility--from June to October 1969.

LTV used, with authorization, about \$2 million worth of the nearly \$18 million in Government-owned IPE at the plant as of June 30, 1971. Company officials could not recall if they had used any of their own equipment. For the use of Government facilities, LTV paid about \$31,000 in rent, most of which was for 9,200 machine hours on IPE. The effective rental rate on IPE was about \$2.35 a machine hour, according to our estimate. The rental rate for each labor hour ( $31,000 \div 72,000$  hours) was \$0.43. Lockheed reimbursed LTV for the actual amount of rent paid.

A representative of the association testified that a composite rate of \$0.31 an hour was negotiated for the use of Government-owned equipment on LTV's tooling orders,

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<sup>1</sup>Awards to North American are discussed on pages 8 and 9.

whereas the corresponding rate for a firm using its own equipment would be about \$4 an hour. We interviewed the representative concerning the basis for the \$4 rate, and he advised us that he did not have any documentation to support it. He advised us also that the rate for his company at full capacity was about \$0.35 an hour, although at current capacity the rate was \$0.72 an hour.

We believe that the formula used by LTV to compute the rent payment was disadvantageous to the Government. Under LTV's formula the gross rental was computed by using the ASPR rates. LTV's share of the gross rent, however, was based on the number of machine hours used on commercial work in relation to the total machine hours available each month--176 hours. In our opinion the only method which can be relied upon consistently to produce an equitable allocation of the rental charge is one in which the total actual machine hours used are the basis for prorating commercial and Government work as provided for in ASRP. In this way the Government and the contractor share in the cost of ownership of the equipment in the ratio that it is used for each purpose.

We were advised by local officials of the Defense Contract Administration Services office that LTV's rental formula complied with the "use and charges" clause of ASPR 7-702.12. The clause states that the measurement unit for determining the amount of use of the facilities by the contractor can be any unit which will result in an equitable apportionment of the rental charge as may be mutually agreed to.

The officials indicated that Defense Contract Audit Agency personnel had been involved in the decision to use this method. The officials indicated also that ASPR, in suggesting the use of actual hours rather than hours available for use, may be directed more toward contractor-owned facilities using Government equipment than toward Government-owned plants. They pointed out that in a Government-owned, contractor-operated plant the facilities were there at all times to accomplish the mission for which the plant was intended.

LTV keeps records indicating the number of machine hours of commercial use but not of Government use; therefore

we could not determine the total hours the machines were used and, as a result, could not compute what the rent should be.

Martin-Marietta Corporation

The Baltimore Division of Martin-Marietta Corporation, Middle River, Maryland, used Government equipment in performing L-1011 tooling and parts fabrication orders awarded by Lockheed during 1969 and 1970. It was not possible to determine the extent to which the equipment was used because Martin did not maintain usage records. There was an average of \$8.7 million worth of Government equipment at Martin during 1969 and 1970 that was available for L-1011 work. The contractor had authorization to use the equipment, and the contractor's rent computations, based on direct labor hours, were in accordance with ASPR. A table summarizing the value of the orders, the labor hours, and rent paid follows.

	<u>Amount</u>	Direct la- bor hours <u>expended</u>	Rent paid for use of Government <u>facilities</u>	<u>Rent per labor hour</u>
	----- (000 omitted) -----			
Sales to:				
Lockheed-California:				
Tool fabrication, de- sign, and liaison services	\$3,930	220	\$63	
Parts fabrication	<u>693</u>	<u>43</u>	<u>14</u>	
Total	<u>4,623</u>	<u>263</u>	<u>77</u>	\$0.29
Lockheed-Georgia:				
Tool fabrication	674	43	12	
Parts fabrication	<u>247</u>	<u>16</u>	<u>5</u>	
Total	<u>921</u>	<u>59</u>	<u>17</u>	\$0.28
Total	<u>\$5,544</u>	<u>322</u>	<u>\$94</u>	

CHAPTER 3USE OF GOVERNMENT PROPERTY ON DEFENSE WORK

The two examples cited by the association concerning competitive advantage on defense work involved awards made to the Avionic Controls Department of General Electric Company (GE), Johnson City, New York, and Marquardt Company, Van Nuys. We found that both contractors had authorization for using, and had used, Government property on a rent-free basis. We concluded, however, that such usage was not the determining factor in their winning the awards. A synopsis of the association's testimony and our findings and conclusions follow.

AWARD TO GENERAL ELECTRIC COMPANY  
FOR MISSILE PARTSAssociation testimony

A GE plant in New York recently underbid a small firm, Fibreform Electronics, Inc., Los Angeles, on a subcontract awarded by Hughes Aircraft Company for the Army's TOW (tube-launched, optically-tracked, wire-command link) missile system. GE bid low because it either anticipated using Government equipment at a fraction of its true rental value or wanted to "buy in" on the program. GE has leased an Air Force plant in Johnson City and is allowed unlimited commercial use of the plant and equipment.

GAO findings

Three of the major units of the missile system, designed primarily as an antitank weapon, are produced by the Hughes Aircraft Company, Culver City, California. During the latter part of 1970, Hughes received quotes from five firms--including GE's Avionic Controls Department and Fibreform, the former supplier--for 363 assemblies required for one of the units.

GE's unit price of \$179, which was the lowest bid, was based on the rent-free use of Government facilities. GE received authorization for rent-free use of the facilities

for the assemblies. Fibreform's bid of \$314 was the next lowest bid. These quotes did not include the costs of required forgings. GE advised Hughes that, without the rent-free use of Government facilities, its total price for the assemblies would be increased by \$1,070, or by about \$3 a unit. We found that the \$1,070 was computed in accordance with ASPR and that it appeared to be a reasonable estimate of the value of the proposed use.

To eliminate the risk of awarding the entire assemblies requirement (subsequently reduced to 353) to GE as a new supplier, Hughes awarded 233 to GE and 120 to Fibreform during February and March 1971. A comparison of the quotes for 353 assemblies and for the actual quantities awarded follows. (These unit prices included amounts for required forgings.)

	<u>Bidding on</u>			<u>Actual award</u>		
	<u>total requirement</u>					
	(Dollar amounts rounded)					
	<u>Quan-</u>	<u>Unit</u>	<u>Total</u>	<u>Quan-</u>	<u>Unit</u>	<u>Total</u>
	<u>tity</u>	<u>price</u>		<u>tity</u>	<u>price</u>	
		<u>(note a)</u>			<u>(note a)</u>	
GE	353	\$240	\$ 84,608	233	\$261	\$ 60,828
Fibre-	353	346	122,092	<u>120</u>	346	<u>41,504</u>
form				<u>353</u>		<u>\$102,332</u>

<sup>a</sup>Fibreform's price includes \$32 for forgings to be supplied by Hughes. GE supplied its own and adjusted its price accordingly.

After deducting the shipping charges from GE's New York facilities to California, Hughes estimated that potential savings, from not awarding the entire amount to Fibreform, would be about \$17,000.

A comparison of GE's negotiated labor estimates with its revised estimates, prepared prior to production, revealed that its labor costs were underestimated. GE officials stated that the underestimate was due to their failure to

adequately consider the manufacturing effort required. Based on the new labor estimates, GE's price would have been about \$405, according to our calculations, and therefore would have been higher than Fibreform's bid.

GE's Avionic Controls Department had about \$9.6 million worth of Government-owned land, buildings, and equipment and \$11.3 million worth of its own equipment at the end of 1970. The leased Air Force plant referred to by the association accounted for about \$6 million of the \$9.6 million. The lease on the plant contains the standard Air Force facilities contract clauses which require the contractor to obtain permission to use equipment and to pay rent for non-Government use. The Avionic Controls Department paid a total of \$30,000 in rent in 1970 for use of Government-owned equipment on commercial work, and rental computations appeared to be in accordance with ASPR. About 97 percent of the Controls Department's annual sales represented Government (rent-free) work.

### Conclusions

We believe the rent-free use of Government facilities by GE was not the determining factor in its receiving the award. The estimated value of such usage, which seemed reasonable, would have increased GE's unit price by only about \$3--not enough to have had any effect on the outcome of the award. We were unable to determine whether GE deliberately had underestimated its labor costs to buy in on the program.

### AWARD TO THE MARQUARDT COMPANY FOR ROCKET WARHEADS

#### Association testimony

A small firm was underbid recently on an Army contract for rocket warheads by the Marquardt Company, a previous supplier. Marquardt, which received between \$500,000 and \$1,000,000 of Government equipment for use on the original buy, claimed that it now was going to use some of its own equipment, acquired as a standby line, and was going to leave most of the Government-owned equipment idle. The small firm offered to lower its bid if it could use the

idle equipment but was told by the Army that the equipment was not available.

Who funded Marquardt's standby line? How will the Government-owned equipment be used? Why is this equipment kept in a plant where it is not needed? The answers to these questions might illustrate serious allocation and surveillance problems in the management of Government-owned equipment.

### GAO findings

In 1969 Marquardt initially was awarded a noncompetitive contract for the rocket warheads (designed for a lightweight antitank weapon system) because technical data was not adequate for competitive procurement. To start production and to establish an accelerated base for mobilization, the Army authorized Marquardt to purchase or construct seven items of IPE at a cost of \$529,000. Only four of the items were used on the 1969 contract; Marquardt had technical problems with the other three.

The competitive contract referred to in the testimony was worth about \$835,000 and was for 193,400 units awarded in two equal parts--one as a labor surplus set-aside--during March 1971. Marquardt was awarded the non-set-aside portion at \$4.32 a unit. Atlas Fabricators, Inc., Long Beach, California, which was the small firm referred to in the testimony, submitted the next lowest bid at \$5.04 a unit.

In accordance with ASPR 13-501, Marquardt's bid included an adjustment (upwards) of about \$0.03 a unit for authorized rent-free use of three (of the seven) items of IPE costing \$53,000. About 87 percent of the machine hours for the contract were to be performed by Marquardt's equipment, according to its estimate. Marquardt was constructing a separate production line with its own funds, which would perform the same operation, at a slower rate, as that of the Government-owned IPE. The use of all seven pieces of Government-owned IPE was not contemplated by Marquardt because it thought that such use would have made its bid less competitive.

We found that, had Marquardt intended to use the seven items of IPE, the adjustment factor would have increased its unit price by \$0.33 a unit to \$4.65--still lower than Atlas. Atlas and Marquardt also were low bidders on the set-aside portion. Atlas was offered it at an adjusted unit price of \$4.36. Atlas protested the award of the set-aside claiming that all bidders should have had the opportunity to bid on the basis of using Government-owned IPE which was available to Marquardt. The Army denied the protest for the following reasons:

- ASPR 13-301 requires that competitive solicitations not include an offer by the Government to provide new facilities or to move existing facilities into contractors' plants unless adequate price competition cannot be obtained otherwise.
- The equipment in question was being used on the current contract (awarded in 1969) which was scheduled for completion in August 1971.
- The Marquardt Company is a base producer of the warhead under the Industrial Readiness Program, and therefore all Government equipment in its possession is required to support the mobilization requirements of the program.

In March 1971 Atlas declined the set-aside which then was awarded to Marquardt.

### Conclusions

The availability and use of Government-owned equipment at Marquardt was not the determining factor in its being low bidder, since even if it had anticipated using all seven pieces of IPE its proposed unit price would have been lower than Atlas. The standby line referred to in the testimony was actually active equipment constructed with Marquardt's own funds, which could be used more economically than the equipment provided by the Government. The Government-owned equipment is being retained at Marquardt, however, to permit accelerated production in the event there is a mobilization requirement.

EXCERPTS FROM TESTIMONY BY REPRESENTATIVES OF THE  
NATIONAL TOOL, DIE AND PRECISION MACHINING ASSOCIATION  
BEFORE THE SUBCOMMITTEE ON  
PRIORITIES AND ECONOMY IN GOVERNMENT  
OF THE JOINT ECONOMIC COMMITTEE

APRIL 28, 1971

STATEMENT OF WILLIAM E. HARDMAN, EXECUTIVE VICE PRESIDENT, NATIONAL TOOL, DIE & PRECISION MACHINING ASSOCIATION, WASHINGTON, D.C.

Mr. HARDMAN. Thank you, Mr. Chairman. We all have very brief statements this morning. I do not think they can be summarized to make them any briefer than they are.

My name is William E. Hardman, and I am executive vice president of the National Tool, Die & Precision Machining Association, a trade organization headquartered in Washington, D.C., representing approximately 8,000 small businesses across the country. These companies are engaged in work essential to all mass production and metalworking: the production of dies, tools, molds, gages, special machines and other similar items, and the service of precision machining. Like any critical industry—and those particularly related to metalworking—we have had a deep and continuous involvement in defense-related work.

Accordingly, our association has maintained a protracted interest in procurement policies of the Federal Government: specifically, those areas in which we have felt that such policies have been disadvantageous for small businesses.

Mr. Chairman, we all listened with interest and full agreement with Admiral Rickover's comments with regard to the disparity that exists in our procurement agency's treatment of large and small contracts. We could easily expend ourselves relating the discriminatory treatment of small business, starting with the award of the contract on a truly competitive basis, all the way through renegotiations, with the sophisticated use of exemption and federally accepted accounting methods for noting overhead and GA costs on Government work, certainly giving the large contractors a tremendous advantage.

One of the big profits of the big crime, which has just now come to the surface, is the use of Government-owned equipment and that is why we are here.

MISUSE OF GOVERNMENT-OWNED EQUIPMENT IN HANDS OF CONTRACTORS

In the course of our participation over the past several years in a number of hearings before subcommittees of the House Small Business Committee, we have commented on a number of problems in the procurement area. But the problems we have found most distressing and most fundamental have been the abuses growing out of the Government's huge investment in machine tools and other production equipment which have been leased to large prime contractors for both Government and commercial usage.

I realize that your subcommittee has also taken a deep interest in this subject. The Government's huge investment in production equipment has represented a tremendous expenditure of taxpayer's dollars, while also maintaining a very high priority in the total defense budget. We believe this program began as a well-intentioned, essential program in World War II (and later in Korea) to meet objectives that could not otherwise be obtained. However, following Korea, the program went totally out of control, and has since resulted in a huge and unnecessary involvement by the Government in the private economy.

Specifically, the Government has created billions of dollars in equipment capacity in the plants of private contractors, much of which bears little or no relationship whatever to the original Government programs for which it was leased. Now—after many investigations, studies, hearings in Congress, and other proceedings—there has seemed to develop a general consensus that the Government should do something to change this situation. But all parties involved have terribly underestimated the deep entrenchment of these leasing programs in our total economy and, in particular, in the defense-related economy. We are hopeful that these hearings, and the information that is developed in them, will help to speed the day when some meaningful phaseout program gets underway.

Our interest in this subject is very simple, and we do not hesitate to call it a selfish interest. Over the past 20 years, Uncle Sam has supplied billions of dollars worth of IPE (Industrial Production Equipment) to the large defense prime contractors that constitute a major customer market for our industry. Most of this equipment has consisted of standard, general purpose machine tools—the same type of machinery which our companies have purchased themselves with their own funds, bearing the full risk of ownership. Most important, usage by a prime contractor of Government-owned IPE has not been limited solely to Government contract work. Rather, it has been used to expand into supplier markets such as ours, with the prime contractor performing both Government and commercial work. This means that small businesses with privately purchased IPE find it difficult to compete with such primes and, accordingly, have lost a large segment of their traditional markets.

The economics are basic and very simple: the system at its best gives a contractor a huge competitive advantage, because Government IPE is not costing as much as private equipment (assuming full usage) and involves no risk of under-utilization. If you do not use it, you do not pay for it.

That is at its best. But, it has not really worked that way. The system has, in fact, permitted virtually unrestricted use of IPE for any purpose a prime contractor wishes to make of it. And in many cases, including some recent ones we will discuss later, little if any thought is given to any reasonable charge for use.

What should be done about this? We should unwind the Government machinery-leasing program as best we can. Here are the priorities as we view them:

#### RECOMMENDATIONS

1. Abolish commercial use completely. This is the prime area of abuse and inequity.
2. Lease no further IPE except in truly essential situations.
3. Pull IPE out of Government-owned, contractor-operated and private contractor facilities unless it is truly essential and continues to be so.
4. Develop some workable means to sell or otherwise dispose of surplus IPE removed from contractor plants, with emphasis on competitive sale.

With that general comment, let me turn to our other witnesses who will offer some recent circumstances of an abusive nature in the IPE leasing program that underscore some of the inequities that I have suggested. I might add that while there are only two company representatives here this morning, the information we will provide comes from quite a number of companies in the industry. I am compelled to say also that, while we are satisfied as to the reliability of all information we are presenting to the subcommittee, we could not, in most cases, give complete documentary proof of these situations, nor would we wish to disclose publicly the names of individuals in the various involved companies who have gathered information. Of course, all of the situations we will comment on before the subcommittee this morning could easily be investigated by the Government, and the truth of our assertions documented. Indeed, we are very hopeful that our participation in these hearings will help to bring about just such an investigation. We feel sure that, when all of the facts are on the table, there will be total agreement in Congress and in the executive branch that action to cure these unfortunate circumstances can no longer be delayed.

Mr. Chairman, I will turn now to our two representatives from the industry. First, I will introduce Mr. William Gentz, president of Gentz Industries in Detroit, Mich. Following Mr. Gentz, we will hear from Mr. Robert H. McCullough, president of Fibreform Electronics, Inc., in Los Angeles, Calif.

Completing our testimony this morning will be our association legal counsel, Mr. William C. Brashares, a member of the Washington law firm of Peabody, Rivlin, Cladwell and Lambert. Following his remarks we will all be happy to respond to any questions the subcommittee members may have.

Thank you.

Chairman PROXMIER. Thank you very much, Mr. Hardman.

Mr. Gentz, please proceed.

**STATEMENT OF WILLIAM GENTZ, PRESIDENT, GENTZ INDUSTRIES,  
INC., DETROIT, MICH.**

Mr. GENTZ. Mr. Chairman, my name is William Gentz and I am president of Gentz Industries, Inc., in Detroit, a small company that builds basic jet engine parts for a wide variety of different customers. Our company has traditionally done a large share of its work in defense and aerospace industries, principally as a subcontractor to some of our country's largest defense firms.

I find it very difficult to come here and testify on problems that tend to place your industry and my own major customers in an unfavorable light. However, these problems affect the interest of every private business and every taxpayer, and unless those of us who have knowledge of the problems come forth, we can hardly expect either sympathy or improvement. Accordingly, I agreed to appear at your request to advise the subcommittee of some specific cases of abuse in the IPE leasing program that have come to my attention either through my own experience or from other firms in our industry.

**GOVERNMENT EQUIPMENT FOR COMMERCIAL WORK**

Those of us who have competed for years for subcontracts for tooling in aircraft and aerospace programs have grown accustomed to the gigantic presence of DOD's IPE in prime contractor plants. It gives a prime an ability and an incentive to do Government work he would otherwise subcontract to us. We have also seen this IPE appear in program after program of a strictly commercial nature, totally unrelated to the reasons for giving the IPE to the primes.

Just taking the more recent commercial aircraft programs built in the United States, some of which are still under construction, a tremendous amount of tooling and machining work that small businesses could have handled—and could have performed at lower cost under true competitive conditions—has been subcontracted from one major prime to another major prime and performed on Government IPE. Here are some of the more notable occurrences in 1970 and 1971 that we have heard about:

Aeronca subcontracted \$500,000 in tooling to North American on the Boeing 747, the work to be performed substantially, if not entirely, on Government equipment.

McDonnell-Douglas gave Aeronca over \$3 million in orders on the DC-10.

Goodyear sent North American \$5 million in orders on the 747.

Boeing sent North American \$7 million in orders on the 727, 737, and 747.

McDonnell-Douglas sent \$5 million in orders to Convair on the DC-10.

McDonnell-Douglas sent \$4 million in orders to North American on the DC-8.

Northrop sent \$3 million in orders to the North American on the 747.

Chairman PROXMIRE. Was all that work done on Government equipment?

Mr. GENTZ. To the best of our knowledge, all or most of it.

Chairman PROXMIRE. Thank you.

Mr. GENTZ. The Lockheed L-1011 Airbus has been a subject of much of this practice. Lockheed has used Government leased IPE in Government-owned, contractor-operated ("GOCO") facilities in Van Nuys, Calif. and Marietta, Ga., for L-1011 work. In the case of Marietta, we learned that 5,000 orders were involved. I understand that the Pentagon was asked to investigate this and that they specifically confirmed this information. They refused to do anything to stop it, however. According to our information, L-1011 tooling orders also went to the DOD leased facilities of LTV in Detroit and Martin in Baltimore.

Rohr Corp., Chula Vista, Calif., sent some of the tooling on its DC-10 subcontracts to its leased facilities in Riverside, Calif.

These situations represent many millions of dollars worth of purely commercial work that would have gone to small businesses on a cost competitive basis but for the fact that Uncle Sam put duplicate capacity in the majors' plants and to a very large extent gave them a blank check as to its use. Hundreds of small businesses in my part of the country and even more in California would not have had to close their doors in 1970 if the Government had not made this IPE available for commercial work.

We think the mere fact that the Government has created this unjustified capacity is a shocking wrong. But apparently it's only the little firm that mortgages its soul to buy its own equipment that feels so strongly about the situation. Others, including most people in Government, shrug it off with some vague comment about the mobilization base and the rental formulas that are supposed to keep everything in perspective. That's the trouble, I suppose, in many of the areas your subcommittee investigates. The IPE monster grew so easily because when a procuring facility or a prime contractor saw a need for some piece of equipment, all higher authority accepted the need on faith.

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## RENTAL RATES LEASED EQUIPMENT INADEQUATE

But what about this matter of rental rates on leased IPE? There is a so-called uniform formula which charges a certain percentage per month of the acquisition cost of the tool, and the percentage declines as the tool gets older. The formula is hopelessly inadequate in many ways. Basically, it just bears no relation to the cost of ownership or even a commercial lease. Nor does the decline in rates as a function of age bear any relation to actual value of the equipment.

Even if the formula made any sense, it seems to be ignored in some very significant cases. Instead, contractors and Government contract personnel negotiate rentals on an individual basis. Two examples of the results of such negotiations may shed some light. The Lockheed L-1011 work that went to LTV in Detroit to be done in a Government-owned, contractor-operated facility, was performed under a negotiated arrangement that featured a "composite" rental rate (meaning for all IPE employed) of \$0.31 per hour. A true industrial rate—one that a firm paying for its own equipment would have to charge—would be on the order of \$4 per hour.

This LTV work represented \$3 to \$5 million in orders, or roughly 350,000 hours, and it required LTV to scramble all over the country to find additional toolmakers. It even advertised in southern California where many small firms that lost out on this work were laying off their skilled people, and LTV picked them up.

An arrangement similar to the LTV situation was entered between Lockheed and Boeing, Wichita for L-1011 tooling. In this case a 76 cents-per-hour composite rate was worked out. We have no idea why they used a different rate. While 250,000 hours were initially targeted for Boeing, we understand that for some reason the parties did not go through with the arrangement.

We do not know what rate was negotiated for Martin's L-1011 work in Baltimore. It is likely that this arrangement involved the most work of all the situations we have noted.

These arrangements are only a few of many such negotiated deals involving commercial use of IPE. And the matter of ridiculously low rental rates is only one aspect of the problem. Consider what other possibilities exist for utilizing DOD's leased facilities to best advantage where Government and commercial programs are going on in the same GOCO plant. Consider how easy it would be to use IPE rent free on commercial work when the rent-free arrangement was figured only into the Government contract being performed. Even though Government personnel may periodically check the contractor's records of Government and commercial IPE use, the supervision process does not go beyond the papers themselves. There is no way, or at least DOD has not found any way, to monitor actual usage of its machine tools. The entire system is really based on nothing stronger than an assumption that contractors will accurately record and pay for actual machine use.

We believe that commercial use must be stopped completely. It has always been abused and will always be abused as long as it is permitted. Virtually every agency in Government or study group that ever considered the pros and cons of commercial use has recommended discontinuance of it. Yet today, a full 20 years after serious criticism of the practice began, we are still no closer to action or a solution. In fact, we find that the total lack of supervision and restriction found by the General Accounting Office in its 1966 report is still the case. The law says no commercial use of IPE over 25 percent of capacity, yet DOD hasn't informed many contractors of this, and from the hundreds of continuing cases of above 25 percent usage, DOD may receive only a dozen applications a year for permission to do so. Through our taxes, we are subsidizing our competition and/or our customers.

Mr. Chairman, what hope do we possibly have to cure some of the truly complicated difficulties in our procurement system when we can't eliminate such a simple and wholly unnecessary favoritism as this? We hope this subcommittee can increase the pressure for change and improvements.

Thank you.

Chairman PROXMIRE. Thank you very much, Mr. Gentz.

Mr. McCullough, please proceed.

**STATEMENT OF ROBERT H. McCULLOUGH, PRESIDENT, FIBREFORM ELECTRONICS, INC., LOS ANGELES, CALIF.**

Mr. McCULLOUGH. My name is Robert McCullough. I am president of Fibreform Electronics, Inc., in Los Angeles, Calif. I am appearing this morning at the request of this subcommittee to provide information on the effects on small business of the use of Government-leased production equipment by the major prime contractors.

My business consists of about 25 highly skilled employees, a building and roughly \$250,000 worth of machine tools. We specialize in precision machining work in the aerospace field. Typically, a prime contractor will send us a blueprint or a rough casting of a part, and we will proceed to machine the solid metal stock or casting to a finished part meeting tolerances as close as a few millionths of an inch. For the 25 years of our existence, we have been almost completely committed to defense or aerospace related work.

Our company, like hundreds of others in southern California, has been going through a painful transition in the past year. Our traditional area of work has declined and we are fighting for new types of work in many areas we never looked at before.

**UNFAIR COMPETITION STEMMING FROM MISUSE OF IPE**

It is perhaps because of the tremendous drop in our traditional work in the past several years that we have become particularly aware of the effects on our markets of the IPE provided by the Government to many of the prime contractors we sell to. We always knew this equipment existed and was involved in a great deal of the same work we were doing, but demand for Government work was greater and there was still an overflow of that work plus other commercial programs. The decline in Government work has led to the primes turning this great capacity loose on commercial and Government subcontract markets they did not seek before. And, costwise, a company buying its own equipment can't compete with this capacity.

Our own company had a rough experience with Government-leased IPE just recently. We had participated for several years in making parts for Hughes Aircraft in the TOW missile program. The program has been segmented into what we refer to as annual "buys," and in each of the first 2 years we were awarded a substantial amount of the machining work on a particular part. For the third-year buy, we were bidding on the greatest number yet of these units. To our great surprise, we discovered that a General Electric facility in New York had bid on the same work and was quoting a price substantially below ours. As a result, GE won most of the work that would otherwise have gone to us and other small firms in California.

GE operates with an overhead far higher than a small company such as ours. There are only two possible explanations for GE's sub-

stantially lower bid. One is that GE was going to use Government equipment, at a fraction of its true rental value. An additional possibility is that GE wished to "buy in" on the program, gain some experience on it, and then bid against Hughes for the prime contract on the fourth-year buy. In any case, we know that GE is the largest holder in the country of Government-owned IPE. We also know that GE recently obtained a nondefense lease of an entire Air Force plant, including equipment, in Johnson City, N.Y., which permits unlimited commercial work.

We do not know all the details, but we believe that an investigation would show that GE gained this work partly or entirely because of a cost advantage based on having Government-owned equipment. If GE is successful in using this advantage to take the entire program over, hundreds of small businesses in California, such as ours, will lose work that is vitally important to their survival.

An interesting situation also developed recently on a prime contract for rocket warheads in which a small firm in Long Beach, Calif., lost out by a wide margin to the Marquardt Co., a large prime that had held the same prime contract previously. Apparently, the Government put somewhere between \$500,000 and \$1 million in special equipment in Marquardt's plant in earlier years for production of this warhead. Yet in bidding this round, Marquardt reflected the cost of only a small fraction of this equipment and came up with an incredibly low figure. Marquardt claims that it's going to use some of its own equipment that it acquired with its own funds as a "standby" line, and will leave the Government equipment idle. But, when the small firm offered to lower its bid if it could get the idle Government equipment, the Army claimed it was not available.

This case, if it were investigated, might illustrate the serious allocation and surveillance problems noted earlier. Who paid for the "standby" line? What actual use of the Government equipment is to occur? Why is the Army insisting on keeping this equipment in a plant where it isn't necessary, at least for pricing purposes?

These situations are the farthest thing from a free enterprise, competitive economy we are so proud to claim in this country. The tragedy is that once the Government gives equipment to a contractor, DOD and the contractor act in every way thereafter as if he owns it and has every right to use it however he can.

#### LOCKHEED L-1011

The recent reaction of the Pentagon to our association's complaint about the commercial Lockheed L-1011 work in Georgia takes the cake on this score. Assistant Secretary Shillito said interference with Lockheed's subcontracting decisions would be contrary to the free enterprise system. The Government spends taxpayer money to put equipment into a plant for some purportedly essential defense purpose, permits its use at a ridiculously low price for totally non-Government work, and then can't halt the abuse because it would be interference with natural market forces.

We hope the Pentagon and our friends in the large prime plants will respond to the leadership of Congress in ending this wasteful and unfair IPE leasing situation.

Thank you.

Chairman PROXMIRE. Thank you. It is a very interesting case you cited to us in the Hughes Aircraft TOW missile program. In fact, I think I will ask the GAO to investigate that. It seems like an extraordinary situation and I would like to have it called to their attention.

Mr. Brashares, please proceed.

STATEMENT OF WILLIAM C. BRASHARES, ATTORNEY, PEABODY,  
RIVLIN, CLADOUHOS & LAMBERT, WASHINGTON, D.C.

Mr. BRASHARES. In the wake of the Admiral's comment on Washington attorneys, I would like to make it perfectly clear I have never worked for the Government.

Chairman PROXMIRE. That is reassuring; thank you.

Mr. BRASHARES. I am pleased to respond to your request to appear this morning as counsel for the National Tool, Die & Precision Machining Association. These hearings could provide effective pressure for change in procurement policies that have long been criticized by this association as well as many other groups.

The matter of phasing out the IPE leasing program and abolishing commercial use may seem a simple matter as we have discussed it. When the discussion turns to mobilization bases, defense capability, and the like—which you will hear about from the DOD witnesses later—however, the zest for reform turns to blank stares. It's an awfully easy matter to bury in paper plans and endless statistics. That may be why so many billions of dollars worth of general purpose machine tools are in contractor plants today and also why they can be explained generally, but rarely specifically.

It may be significant, then, that whenever the hard facts and figures have been looked at, the IPE leasing, and particularly commercial use, have been criticized.

In a 1966 report the General Accounting Office noted case after case of abusive commercial use and recommended that consideration be given to eliminating it entirely.

GAO's recent report on contractor profits recommended that contractors using Government equipment should have this lower risk reflected in lower negotiated profit levels under the weighted guidelines.

The Rand Corp.'s 1969 report on Government furnished equipment—prepared for the Air Force and based on Air Force equipment—noted that leased IPE was almost entirely general purpose (thus duplicating private capacity), that it was too easy to use equipment for commercial work, that by favoring certain contractors with leased equipment, the Government was losing the benefits of increased competition, and, concluding: the Vietnam buildup of the Air Force IPE inventory "should be halted and alternatives sought before the problem becomes mountainous."

Another private study group, the Logistics Management Institute, which the Admiral mentioned this morning, rendered a report in 1967 for the Assistant Secretary of DOD (I. & L.) called "Weighted Guideline Changes and Other Proposals for Incentives for Contractor Acquisition of Facilities." Among other things, the report urged an increase in rental rates for commercial use. Rates were increased subsequently, but not as high in most cases as LMI thought would be "equal to commercial rates or what it would cost a contractor if he owned the equipment."

LMI observed in its report: "DOD's policy, as expressed many times since 1956, has been for the Government to withdraw from the facilities-furnished field. It has executed this policy vigorously." Thus the words of LMI, whose head back in 1967 was Barry J. Shillito, the man who now administers this entire program as DOD's Assistant Secretary for Installations and Logistics.

DOD PURCHASE OF MACHINE TOOLS HAS INCREASED

To illustrate the phaseout, LMI noted that 1955 to 1965 machine tool purchases by DOD averaged about \$50 million per year but that purchases went up to \$140 million in 1966. (That was about 5 percent of total U.S. machine tool sales in 1966, incidentally.)

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In late 1969, DOD Deputy Assistant Secretary John Malloy confirmed in a House Small Business Subcommittee hearing that DOD was spending about \$100 million per year for new machine tools in the previous several years. This being, in Mr. Shillito's words, a vigorous phaseout policy, we are thankful DOD did not maintain the status quo.

In reviewing these past reactions to the IPE leasing program, I don't mean to ignore the involvement of Congress, particularly this subcommittee and Mr. Corman's House Small Business Subcommittee on Government Procurement. Your subcommittee's 1967 report noted the failure of contractors to seek approval for commercial use in excess of 25 percent and cited examples of abusive commercial use.

We are also aware of the legislation recently introduced by your chairman, S. 1469, to abolish commercial use and place tight but reasonable limits on future IPE leasing. Mr. Corman's subcommittee issued a report in 1970 condemning these abuses in the IPE leasing program and recommending reform. Incidentally, Mr. Malloy testified in the House hearings that DOD itself was taking steps to "eliminate the leasing of Government equipment for other than Government work." Perhaps if all parties were communicating we would find a surprising level of agreement.

We are concerned as to whether all of this study, restudy, and criticism of the IPE situation is having any effect at the Pentagon. We have seen policy statements and orders relating to phaseout of IPE leasing come forth from the Pentagon in the past several years. We heard former Deputy Assistant Secretary, General Stanwix-Hay, openly condemn the inequities of the program and assure a prompt phaseout before another House Small Business Committee in 1969.

Just last December we learned that DOD was undertaking an intensive mobilization study before going ahead with any phaseout plans. In February, Deputy Secretary Packard issued a memorandum reiterating generally the phaseout policy, but creating exemptions from phaseout for some awfully broad and vague situations, one of which would defer action on individual cases where removal of Government-owned IPE would "work an economic hardship." Perhaps there should be some comparison of economic hardships based upon the kinds of situations you have heard about earlier today.

Mr. Chairman, if your subcommittee can somehow untangle the facts, figures, and personalities that have delayed reform in this matter for 20 years, you will have made a magnificent contribution to the taxpayers, the principle of competition and the small business community. I hope our information and views have been of some help.

Thank you.

APPENDIX II

SCHEDULE OF AWARDS, RENTS PAID, AND ACQUISITION COSTS  
OF GOVERNMENT-OWNED PROPERTY IN THE CUSTODY OF CONTRACTORS

Awarded to	Contractors Received from	Value of awards (000 omitted)	Program	Time period	Rent paid (000 omitted)	Government property in of performing contract of 8-30-71 (no.)	
						Real property	Equipment
						(000 omitted)	
North American Rockwell Corp. Los Angeles, Calif.	Aeronca, Inc. Torrance, Calif.	\$ 215	Lockheed L-1011	1969-70	\$ 5		
	Boeing Co. Seattle, Wash.	25,565	Boeing 727, 737 & 747	1965-69	456		
	Goodyear, Aerospace Corp., Litchfield Park, Ariz.	6,500	Boeing 747	1966-69	113		
	Lockheed Aircraft Corp. Burbank, Calif.	1,918 <sup>b</sup>	L-1011	1968-70	39		
	McDonnell-Douglas Corp. Long Beach, Calif.	15,202	McDonnell- Douglas DC-8 & 9	1964-68	107		
	Northrop Corp., Hawthorne, Calif.	<u>12,929</u>	Boeing 747	1967-68	<u>239</u>		
		62,329			959 <sup>a</sup>	\$ -	\$ 19,212
General Dynamics Corp., San Diego, Calif.	McDonnell-Douglas Corp.	45,000 <sup>c</sup>	DC-10	(d)	(d)	7,867	26,599
Rohr Corp. Chula Vista, Calif.	McDonnell-Douglas Corp.	(d)	(d)	DC-10	18 <sup>c</sup>	-	5,906
Lockheed-California Co. Burbank, Calif.	(Performed tooling work in-house)	(d)	L-1011	1968-present	285	15,779	27,972
Lockheed-Georgia Co. Marietta, Ga.	Lockheed-California Co.	3,000 <sup>c</sup>	L-1011	1969-71	39 <sup>c</sup>	103,745	41,019
LTV Aerospace Corp. Sterling Hgts., Mich.	Lockheed-California Co.	1,000	L-1011	1969	31	37,665	19,691
Martin Marietta Co. Middle River, Md.	Lockheed-California Co. Lockheed-Georgia Co.	3,930	L-1011	1969-70	63		
		674	L-1011	1969-70	12	96	7,663
General Electric Co., Johnson City, N.Y.	Hughes Aircraft Co. Culver City, Calif.	61	TOW missile	1971	(f)	5,905	3,751
Marquardt Co. Van Nuys, Calif.	U.S. Army Munitions Com- mand, Joliet, Ill.	835	M18E2 rocket warheads	1971	(f)	<u>11,094</u>	<u>6,337</u>
Total		<u>\$116,829</u>			<u>\$1,407</u>	<u>\$182,151</u>	<u>\$158,150</u>

<sup>a</sup> Obtained from Department of Defense records.

<sup>b</sup> Award added by GAO.

<sup>c</sup> Estimated by contractor.

<sup>d</sup> Could not be determined.

<sup>e</sup> As of September 1, 1970.

<sup>f</sup> Rent-free use allowed.