

DOCUMENT RESUME

05714 - [B1226183]

[Priorities and Materials Allocations under Defense Production Act]. ID-78-39; B-36983. April 24, 1978. 3 pp. + enclosure (9 pp.).

Report to Rep. Charles J. Carney, Chairman, House of Representatives: Congressional Steel Caucus; by J. Kenneth Pasick, Director, International Div.

Issue Area: International Economic and Military Programs (600);
International Economic and Military Programs: U.S.
Comparative Advantage in Trade and Technology (608).

Contact: International Div.

Budget Function: Natural Resources, Environment, and Energy:
Water Resources and Power (301).

Organization Concerned: Department of Commerce; General Services Administration.

Congressional Relevance: Rep. Charles J. Carney.

Authority: Defense Production Act of 1950. Energy Policy and Conservation Act of 1975.

The Defense Production Act and its implementing regulations and procedures were reviewed to determine the procedures established for priorities and materials allocation support for energy programs. The Department of Commerce's Assistant Secretary for Industry and Trade has advised that it is difficult to estimate the potential demand for domestic steel or other materials under this program. However, he believes that the authority of the statute is intended to be used sparingly and does not anticipate that the impact on steel producers will be great. Since the program is new, it is not possible to judge how well it will work. During past periods of shortages in processed materials, some Federal programs of vital national interest have been delayed. During shortages in 1973 and 1974, defense contractors were not as adversely affected as nondefense contractors since the former had priority ratings. The authority of a single agency to administer priority programs prevents creation of a materials priorities and allocation system that would conflict with the Defense Priorities System and the Defense Materials System (DPS/DMS). One of the features of the DPS/DMS system is the Special Priorities Assistance Program which is intended to resolve conflicts when a defense-related contract or order is refused or the delivery date is not met. This program will not be available for energy programs and projects. (RRS)

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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

APR 24 1978

INTERNATIONAL DIVISION

B-96983

The Honorable Charles J. Carney, Chairman
Congressional Steel Caucus
House of Representatives

Dear Mr. Chairman:

In your letter of February 9, 1978, to the Comptroller General, you requested, among other things, GAO's views on the procedures being established for priorities and materials allocation support for energy programs, as authorized by Section 101(c) of the Defense Production Act. As agreed in the March 7, 1978, meeting between the Staff Director, Congressional Steel Caucus and members of my staff, we are providing information as it is developed on each portion of your request. This letter responds to item 7 of your letter.

We have reviewed the background of Section 101(c) of the Defense Production Act, the division of responsibilities among the General Services Administration and the Departments of Energy and Commerce and the implementing regulations and procedures. The Department of Commerce's Energy Regulation 1 will soon be issued, thereby completing the system for authorizing priority ratings and material and equipment allocations for qualifying energy programs and projects.

The Department of Commerce's Assistant Secretary for Industry and Trade has advised us that it is difficult to estimate the potential demand for domestic steel or other materials under this program. Nevertheless, he believes that the authority of the statute is intended to be used sparingly and, thus, he does not anticipate that the impact on steel producers will be great.

Since the program is new, it is not possible for us to judge how well it will work. Prior GAO reviews of the priorities and allocations system for defense-related programs, however, indicate some of the difficulties and problems which may occur.

ID-78-39

We previously reported that during periods of shortages in processed materials, such as steel, aluminum, castings, forgings and electronic components, some Federal programs of vital national interest were delayed. ("Impact of Shortages of Processed Materials on Programs of Vital National Interest," Feb. 27, 1976, PSAD-76-14). We found that during 1973 and early 1974, when the U.S. economy was troubled by the most serious shortages since the Korean War, defense contractors were not as adversely affected as nondefense contractors, since the former had defense priority ratings. We, therefore, recommended that the Congress consider amending the Defense Production Act to broaden application of the priority and allocation authority to include nondefense programs of vital national interest, such as the development of energy resources. Section 101(c) of the Defense Production Act is consistent with our recommendation because it extends priority and allocation authority to programs and projects which maximize domestic energy supplies.

In the same report, we also recommended that, to prevent competition among priority programs, a single agency should be authorized to administer the programs. The inclusion of the authority in the Defense Production Act preserves this principle by not creating a second materials priorities and allocation system that would conflict with the existing Defense Priorities System and the Defense Materials System (DPS/DMS). The Industry and Trade Administration of the Department of Commerce will administer both the energy and defense-related programs through DPS/DMS regulations and orders. The Federal Preparedness Agency of the General Services Administration is responsible for direction, control, and overall coordination. This responsibility includes resolving any conflicts between competing requirements for materials and equipment for energy and defense-related programs.

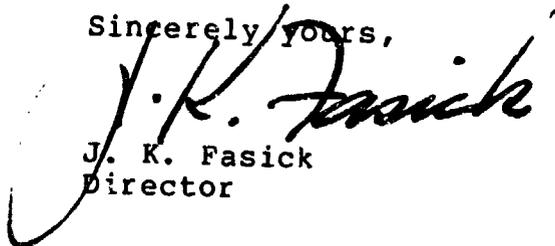
One of the features of the DPS/DMS system is the Special Priorities Assistance Program, which is intended to resolve conflicts when a defense-related contract or order is refused or the required delivery date is not met. This assistance program now will be available for energy programs and projects. In a prior review of the use and effectiveness of the Special Priorities Assistance Program, we identified a number of problems in the starting and processing of assistance requests ("Special Priorities Assistance Program: Its Shortfalls and its Possibilities,"

Apr. 2, 1976, PSAD-76-93). One of the major problems was a lack of understanding of the DPS/DMS system and the Special Priorities Assistance Program. We recommended that the Department of Commerce work more closely with industry to insure better understanding of the program. We further recommended that the Department of Defense, the General Services Administration, and the Energy Research and Development Administration (now part of the Department of Energy) complement Commerce's efforts. Commerce has advised us that, together with these agencies, it has held a series of joint seminars throughout the United States to familiarize prospective energy contractors with the new priorities support for energy programs.

We are enclosing an outline, prepared by the Department of Commerce, of the procedures to be followed in implementing Section 101(c) of the Defense Production Act. We also have enclosed copies of the previously mentioned GAO reports. Please let us know if you require additional information.

As agreed with your office, we are sending copies of this letter to the Chairman, House Committee on Government Operations, and to Representative Morgan J. Murphy.

Sincerely yours,



J. K. Fasick
Director

Enclosures - 3

PREPARED BY INDUSTRY AND TRADE
ADMINISTRATION, DEPARTMENT OF COMMERCE

ENERGY PROGRAM PRIORITIES

A. Background and Authority

Section 104 of the Energy Policy and Conservation Act of 1975 (EPCA) amended the Defense Production Act of 1950 (DPA), as amended, by adding Section 101(c) thereto. Section 101(c) of the Defense Production Act authorizes the President, after certain findings are made, to require the allocation of, or the priority performance under contracts and orders relating to, supplies of materials and equipment in order to maximize domestic energy supplies. This authority was included in the DPA so as not to create a second materials priorities and allocations system that would conflict with the existing Defense Priorities System and the Defense Materials System (DPS/DMS). Before granting priorities authority for energy projects the President is required to find that:

- (a) such supplies are scarce critical and essential to maintain or further (i) exploration, production, refining, transportation, or (ii) the conservation of energy supplies, or (iii) for the construction and maintenance of energy facilities; and
- (b) maintenance or furtherance of exploration, production, refining, transportation, or conservation of energy supplies or the construction and maintenance of energy facilities cannot reasonably be accomplished without exercising the authority.

To implement this authority, the President issued Executive Order 11912 delegating his responsibility for making the aforementioned findings through the General Services Administration (GSA) to the Department of Commerce (DOC) and through the Department of Commerce to the Federal Energy Administration now the Department of Energy (DOE). The Federal Preparedness Agency (FPA) of GSA is responsible for the direction, control, and overall coordination of Section 101(c) of DPA, including resolution of any conflicts between claimant agencies regarding particular supplies of materials and equipment.

DMO-13, promulgated by the FPA, provides for the delegation to DOC of the priorities and allocations authority of Section 101(c). It also provides policy guidance in implementing priorities and allocations authority to ensure that:

- (a) supplies of materials and equipment are available on time,
- (b) requirements are equitably distributed among suppliers,
- (c) requirements are not in excess of actual needs, and
- (d) the program is implemented in such a way as to minimize hardship in the marketplace.

DMO-13 delegates to the DOC the responsibility for finding whether supplies of materials and equipment for which priorities and allocations authority is requested are scarce, critical and essential, and whether or not there is a need to use the authority of the statute. DMO-13 also requires the DOC to redelegate to the DOE responsibility for finding that supplies of materials and equipment are critical and essential.

BDC Del. 4 is the formal redelegation of responsibility for making the critical and essential findings from the DOC to the DOE. It also authorizes the DOE, to assign priority ratings after all required findings are made.

The Secretary of Commerce has assigned the responsibility for administering energy priorities and allocations authority to the Industry and Trade Administration (ITA). The implementation of this authority is accomplished through regulations and orders called the Defense Priorities System (DPS) and the Defense Materials System (DMS).

B. Processing Applications for Priorities and Allocations

In processing applications for priorities and allocations, certain findings and determinations, as stated in Part A, must be made before approval can be granted. The DOE must:

- (a) determine whether the energy program or project for which priorities and allocations authority is requested maximizes domestic energy supplies, and
- (b) find whether or not the supplies of materials and equipment are critical and essential to the program or project.

C. Department of Energy Responsibilities

DOE has established that the term "maximize domestic energy supplies," should include, but not be limited to, energy programs or projects which will contribute to the overall objective of improving our Nation's energy resource situation. This concept will include programs or projects which:

- (a) increase quantities of domestic energy,
- (b) conserve and reduce the demand for energy, especially non-renewable sources of energy,
- (c) convert to more abundant sources of energy,
- (d) promote decreased reliance on foreign sources of energy, and
- (e) promote more efficient use of energy.

The criteria used in determining whether an energy project or program maximizes domestic energy supplies include, but are not limited to, the following:

1. The quantity of energy involved: the amount of energy produced by the program or project and the quantity estimated to be lost or not produced if delays occur. An energy program or project producing or conserving substantial amounts of energy would be given more consideration for priorities than one which did not.
2. Benefits of timely project completion: the amount of energy conserved or produced or the amount of imported energy saved by timely completion of the energy program or project.
3. Impact: the impacts, if any, caused by delays in the timely completion of the energy program or project. For example, if there is a delay in the completion of a natural gas pipeline which would cause the closing of plants or critical local facilities, more favorable consideration would be given to the granting of priorities assistance.

4. The need for the end product for which the materials and equipment are allegedly required: priorities assistance will not be granted for a component of a product unless the end product itself is found to be needed. For example, if there is a shortage of the steel for offshore rigs, but there is a surplus of rigs, priority assistance would not be authorized.
5. Established national energy policies: in areas for which a national energy policy has been stated, a program which will result in reduced dependence on foreign oil and a decrease in supply disruptions will be accorded the highest consideration for granting of priority authority.

After the maximization determination has been made, the program or project will be referred to as "eligible." In subsequent applications involving the same project, no repeat finding of maximization is necessary. Once a project is determined to be "eligible," it remains so until the DOE decides otherwise.

The DOE will next consider whether the supplies of the material and equipment for which priorities and allocations authority is requested are essential and critical to the timely completion of the project or program. The determination of essentiality and criticality of certain supplies of material and equipment for the purposes described will be made by DOE on a case-by-case basis.

In making the finding of essentiality, the basic consideration is whether the supplies of material and equipment are considered indispensable to the approved program. The criteria for making this finding include:

- (a) the item must be fundamental, i.e. an absolute requirement must exist for the specific material or equipment, and
- (b) no substitute material and equipment are readily available.

The finding of criticality concerns the urgency of obtaining the particular material and equipment which will be required if priorities and allocations rating authority is granted.

In making these findings the DOE will consider the availability and utility of substitute materials or equipment, the impact of the availability of the specified materials or equipment on the timely fulfillment or completion of the program or project and such other factors as DOE deems appropriate. If DOE finds that the supplies of materials and equipment are critical and essential, it will designate the applicant an "energy contractor."

If the DOE decides that additional information is required to make these findings, the applicant will be requested to make such information available.

Applications for programs or projects which are determined by DOE to maximize domestic energy supplies and for which supplies of materials and equipment are found to be critical and essential will be forwarded to ITA, Office of Industrial Mobilization (OIM), for further processing.

If, however, DOE does not find that the materials and/or equipment are critical and essential, and/or does not determine that the energy program or project maximizes domestic energy supplies, the application will be considered to have been denied. DOE will promptly inform the applicant of its decision. If dissatisfied, the applicant may appeal this decision.

D. Department of Commerce/Industry and Trade Administration Responsibilities

The ITA is responsible for finding:

- (a) whether the supplies of materials and equipment are scarce, and
- (b) whether the program or project can reasonably be accomplished without exercising the priorities and allocations authority.

ITA's proposed regulation regarding section 1(j)(c) of the DPA defines the term "scarcity" as implying unusual difficulty for the purchaser in obtaining the materials or equipment in appropriate specification, quality, quantity and in a time span consistent with the purposes of the program or project.

Sources of supply considered in respect to the scarcity determination include all persons who are capable of meeting required product specifications, quality and quantity within the required time frame.

In determining whether the supplies of materials and equipment are scarce, ITA proposes to consider the following factors:

- (a) shipments,
- (b) consumption,
- (c) imports and exports,
- (d) sources of supply,
- (e) inventories of producers, users and traders,
- (f) rates of capacity utilization,
- (g) volume of new orders, and
- (h) average lead time for filling orders.

In making the finding of whether there is a need to use the system, ITA proposes to consider the following factors:

- (a) alternative solutions to the supply problem,
and
- (b) to the extent practicable, an assessment of the effects of using the authority for the project in question on other rated projects.

If either of the above findings are negative, ITA will so inform DOE and the application will be denied. If both findings are positive, ITA will authorize DOE to grant priority rating authority to the applicant.

If either of the ITA findings is negative, the applicant or the DOE may appeal the ITA decision by submitting a request for reconsideration in triplicate to the Office of Industrial Mobilization, Industry and Trade Administration, U.S. Department of Commerce. OIM/ITA will consider the petition and either grant or deny the relief requested. Written notice of the decision and the reasons therefore will be provided to the applicant.

If the DOE and the ITA act favorably on the application, the ITA will assign the appropriate rating symbol and authorize the DOE to grant priority authority to the applicant to obtain the needed supplies of materials and/or equipment. DOE will authorize, in writing, priority authority to the applicant and will assign a program identification symbol to be affixed to contracts or orders. In using the priority authority, the applicant will be governed by all rules and regulations of the Defense Priorities System and the Defense Materials System.

E. Placing rated orders under the Defense Priorities System

The DPS provides the basic rules governing the use of priorities for any material other than the controlled materials (steel, nickel alloys, aluminum and copper). After authorization by the ITA, the DOE assigns to the contractor a priority rating, which consists of the prefix DO or DX followed by the appropriate program identification symbol. The priority rating (e.g. DO-F-5), must be placed on all contracts or purchase orders. A rated order must contain the following information:

- (a) date or dates on which delivery is required,
- (b) a statement reading substantially as follows:
"You are required to follow the provisions of DPS Reg. 1 and of all other applicable regulations and orders of ITA in obtaining materials and services needed to fill this order,"
- (c) certification stating:
"Certified for use under DPS Reg. 1," and
- (d) the signature of an authorized official of the firm placing the rated order. This may be either a manual representation or an authorized facsimile.

Contractors and suppliers are required to schedule production of rated orders so as to meet the required delivery dates as stated on the contract. In scheduling production and/or delivery, the DX rated orders take precedence over all DO rated orders and all unrated orders. The DO rated orders take priority over unrated orders.

Between rated orders with the same designation (either DO or DX), the order received on the earliest date takes precedence. If more than one equally-rated order is received on the same day, priority is to be given to the order requiring the earliest delivery.

When any person receives a rated contract or purchase order, he is considered to be a self-authorizing consumer, and must extend the priority rating in obtaining materials and services required to fill the contract or purchase order. Extension of the priority rating helps ensure that eligible programs or projects are maintained on schedule and prevents any unnecessary delay in receiving needed materials and/or equipment. A self-authorizing consumer must fill rated orders with materials and/or equipment in his inventory. However, if in doing so, he would stop or interrupt his operations during the following 60 days, he may instead place a rated order to obtain the needed material and equipment. With respect to inventory replacement of materials and equipment, a contractor is authorized to place rated orders to replace stock taken from inventory used in the filling of a rated order.

In placing rated orders, a contractor may request only the amount of the material and/or equipment needed to fill the rated order. Therefore, he must not combine rated and unrated orders.

F. Placing rated orders under the Defense Materials System

The DMS provides the basic rules governing the use of priorities for controlled materials. (steel, nickel alloys, aluminum and copper)

Any person who receives a rated order becomes a self-authorizing consumer of controlled materials. In the event he requires a controlled material for completion of a rated order, he must place an Authorized Controlled Material (ACM) order to obtain such material.

There are two types of ACM orders:

- (a) ACM - analogous to the DO rating in the DPS, and
- (b) ACM-DX - same as the DX order in the DPS.
Can only be assigned by Presidential direction.
Takes precedence over ACM orders.

All ACM orders must contain four elements: (DMS Reg. 1 Sec. 9)

- (a) The required delivery date or dates,
- (b) A statement reading substantially as follows:
"You are required to follow the provisions of DMS Reg. 1 and of all other applicable regulations and orders of ITA in obtaining controlled materials needed to fill this order,"
- (c) The following certification:
"Certified for use under DMS Reg. 1," and
- (d) The signature of an authorized official of the firm placing the order. This may be either a manual representation or an authorized facsimile.

A self-authorizing consumer must fill rated orders from his inventory. If controlled materials were used from inventory, he may then replace them by placing ACM orders in the month that the material was used, or during the following two months. If, however, by using his inventory, he would disrupt operations during the succeeding 60 day period, a producer may instead place an ACM order to obtain the required materials.

In placing ACM orders, a contractor may request only the amount of material needed to fill the rated order, and he may not request delivery earlier than it is needed. However, if a contractor requires less than the minimum mill quantity as specified in DMS Reg. 1, Schedule IV, he may either combine rated orders under the B-5 program determination, or if this is not possible, he may order the minimum mill quantity. However, he should also attempt to place orders for small quantities with small distributors. In placing ACM orders, the contractor must allow the producer acceptable lead time in accordance with Schedule III of DMS Reg. 1.

Producers of steel, nickel alloys, aluminum and copper are required to set aside a portion of their products for defense purposes. The quantities of the set-asides are based on the ratio between current defense needs and the shipments made during a base period. The major purpose of the set-aside technique is to assure an equitable distribution of the requirement of filling rated orders among the several producers.

An ACM order may be refused by the producer if the producer has already reached the applicable set-aside or if the set-aside would be exceeded by acceptance of the order, except that DX rated orders must be accepted without regard to the set-aside.