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Fact Sheet for the Chairman, Legislation
and National Security Subcommittee,
Committee on Government Operations,
House of Representatives

May 1992

NAVAL AVIATION

Events Surrounding the Navy's A-12 Aircraft Program

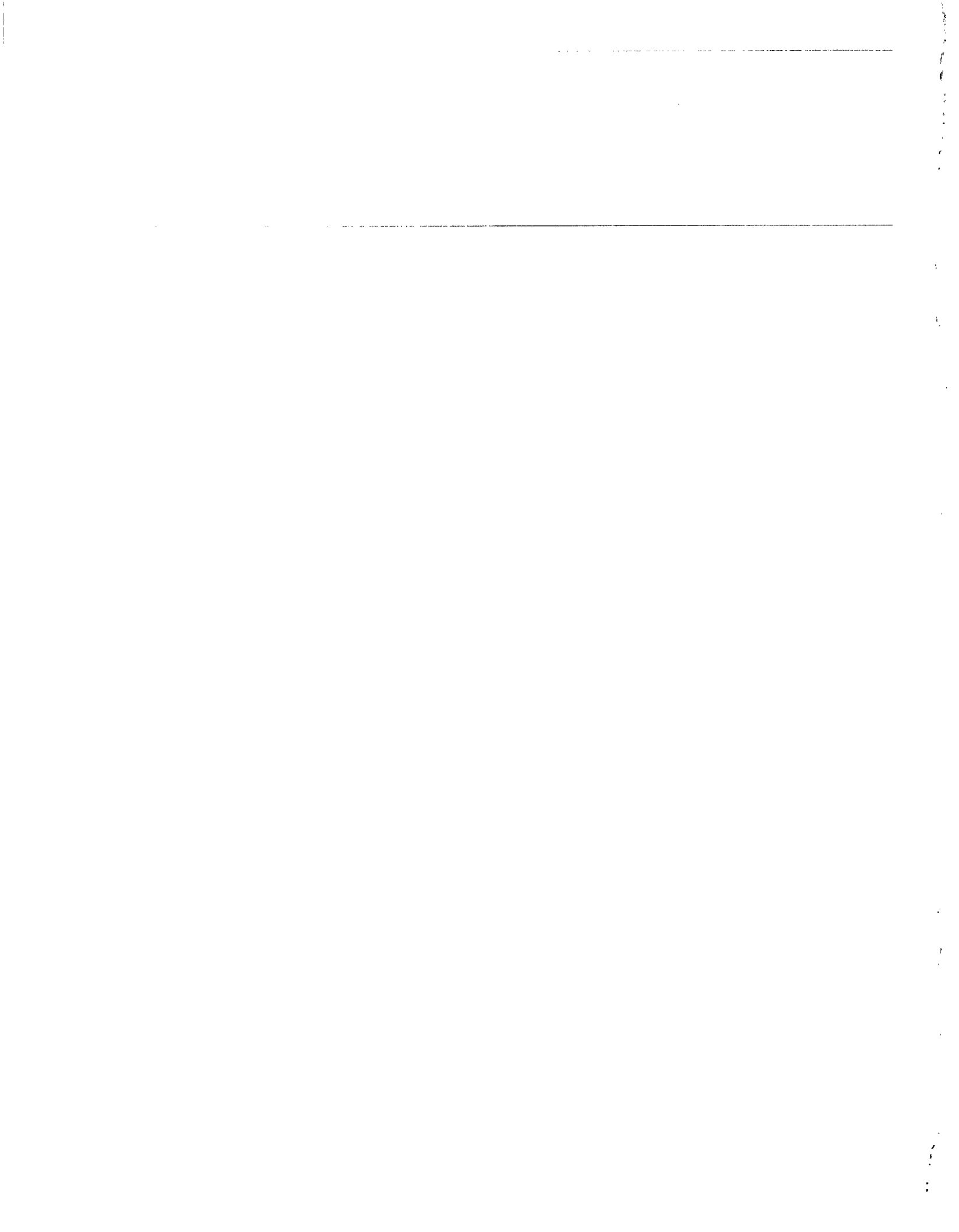


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National Security and
International Affairs Division

B-248504

May 12, 1992

The Honorable John Conyers, Jr.
Chairman, Legislation and
National Security Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

As requested, we are providing you with information on significant events that affected the A-12 program and payments made to McDonnell Douglas.

Background

In the 1980s, the Navy began a program to replace its aging fleet of A-6 medium attack aircraft with a new aircraft, the A-12, that would incorporate stealth technology and could be deployed from an aircraft carrier. In January 1988, the Navy awarded a fixed-price incentive contract for full-scale development of the A-12 to the team of General Dynamics and McDonnell Douglas Corporations. The contract had a target price¹ of \$4.4 billion and a ceiling price² of \$4.8 billion.

On January 7, 1991, the Navy terminated the A-12 contract for default due to difficulties the contractors had in executing the contract. The government had made \$2.68 billion in progress payments to the contractors, but only \$1.33 billion was for items delivered to and accepted by the government. Expenditures had not exceeded the contract's \$4.4 billion target price. However, at the time of termination, the Navy was projecting that program costs would exceed the contract's ceiling price of \$4.8 billion and that the A-12's first flight would be delayed by over 2 years. The government asked the contractors to return \$1.35 billion paid for work that had not been accepted but then agreed to the contractors' request to defer repayment.

¹Target price is the sum of target cost, which is the best, mutually negotiated estimate of what the cost will actually be, and target profit, which is negotiated between the government and the contractor.

²Ceiling price is the highest price that the government is required to pay under the contract.

Results in Brief

Appendix I provides a list of significant events affecting the Navy's A-12 program, including the Secretary of Defense's Major Aircraft Review in December 1989. After the Secretary's April 1990 testimony on the results of the review, the A-12 contractors disclosed that the date of the A-12's first flight would slip significantly and that the cost of full-scale development would overrun the contract ceiling by an amount that the contractors could not absorb. The chronology extends through June 1991, when the A-12 contractors filed a lawsuit in U.S. Claims Court, asking, among other things, for a judgment that the A-12 contract was terminated for the convenience of the government. According to the Navy, if the court rules that the termination was for the convenience of the government, rather than a default for nonperformance, the contractors may not be required to return the \$1.35 billion in progress payments. The lawsuit is still pending.

Appendix II lists the payments made to McDonnell Douglas for work on the A-12 full-scale development contract. These payments totaled \$1.4 billion and were made monthly from contract award to contract termination. General Dynamics was paid about \$1.3 billion for its work on the A-12 full-scale development contract. Appendix II also shows the \$25.6 million in additional payments made to McDonnell Douglas for A-12-related work under a separate basic ordering agreement.³ These payments were made from contract award to February 1992.

Scope and Methodology

In preparing this fact sheet, we reviewed documents and interviewed officials from the Navy, McDonnell Douglas, and General Dynamics. We performed our work during February and March 1992 in accordance with generally accepted government auditing standards.

As you requested, we did not obtain written agency comments on this fact sheet. However, we discussed the information in the fact sheet with Department of Defense and Navy officials who were responsible for the A-12 program and payments made to McDonnell Douglas. The officials agreed with the information as presented.

³A basic ordering agreement is negotiated between the government and a contractor when specific items, quantities, and prices are not known at the time the agreement is reached. It is not a contract and does not imply any agreement to place future contracts or orders with the contractor.

As arranged with your office, unless you publicly announce this fact sheet's contents earlier, we plan no further distribution until 30 days from the issue date. At that time, we will send copies to the Secretaries of Defense and the Navy, the Directors of the Defense Logistics Agency and the Office of Management and Budget, and appropriate congressional committees. We will also make copies available to others on request.

Please contact me on (202) 275-6504 if you or your staff have any questions concerning this fact sheet. Major contributors to this fact sheet are Norman J. Rabkin, Associate Director; William C. Meredith, Assistant Director; and Joseph P. Raffa, Evaluator-in-Charge.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Martin M. Ferber", with a long horizontal flourish extending to the right.

Martin M Ferber
Director, Navy Issues

Significant Events Affecting the A-12 Program

1989

12/15/89

The Navy accepted the Phase II Critical Design Review, associated testing for the Phase II Critical Design Review, and a Program Management Review as complete, although the contractors' work was incomplete. As a result, according to the Navy's Administrative Inquiry, dated November 28, 1990, McDonnell Douglas and General Dynamics received payments for work not substantially completed at the time of payment. (These reviews comprised a portion of the \$1.33 billion in work accepted by the Navy.)⁴

12/19/89

The Secretary of Defense directed a Major Aircraft Review of four programs, including the A-12 program. The primary emphasis of the review was to determine the impact that changes in world events had on the future need for these weapon systems.

1990

4/26/90

The Secretary of Defense, testifying before the House and Senate Armed Services Committees on the results of the Major Aircraft Review, stated that he would continue the A-12 program at reduced procurement quantities and that the A-12's first flight would be in early 1991. The Secretary did not identify any impediments to completing the full-scale development effort within the scope of the current contract.

6/1/90

McDonnell Douglas and General Dynamics advised the Navy that the schedule for first flight would slip significantly, the full-scale development effort would overrun the contract ceiling by an amount they could not absorb, and certain performance specifications could not be met.

⁴The Navy had designated the Critical Design Review, Program Management Review, and other design and management reviews as deliverable items to provide additional funding to the contractors to relieve the financial burden of assuming a significant share of the A-12's development costs. See Naval Aviation: Status of Navy A-12 Contract and Material at Termination (GAO/NSIAD-91-261, July 24, 1991) for additional information.

Appendix I
Significant Events Affecting the A-12 Program

8/24/90

McDonnell Douglas and General Dynamics requested the use of flexible progress payments with a reimbursement rate of 97 percent. The normal reimbursement rate is 80 percent.

10/12/90

In accordance with a Defense Contract Audit Agency recommendation, the Navy refused to authorize a flexible progress payment rate. The Agency stated that the contractors provided neither valid nor adequate information to support a flexible progress payment rate.

12/31/90

McDonnell Douglas and General Dynamics filed a \$1.4 billion claim with the Navy for a contract price adjustment. As the basis for the claim, the contractors cited (1) the Navy's failure to disclose certain facts vital to their performance; (2) delays and disruptions, which they claimed resulted from the Navy's conduct; (3) the Navy's flawed acquisition strategy; and (4) the commercial impossibility of performance.

1991

1/7/91

The Navy terminated the A-12 contract for default because McDonnell Douglas and General Dynamics were unable to complete the design, development, fabrication, assembly, and test of the A-12 aircraft within the contract schedule or deliver an aircraft that would meet contract requirements. At termination, the government had paid the contractors \$2.68 billion on the full-scale development contract. The Navy had accepted six design and management reviews for which it paid \$1.33 billion. The contractors received an additional \$1.35 billion in progress payments for work that had been done on the A-12 contract but had not been accepted at the time of contract termination.

2/5/91

The Navy demanded that McDonnell Douglas and General Dynamics repay \$1.35 billion in unliquidated progress payments. The contractors requested, and the Navy granted, a deferral of the repayment until disputes over the termination were settled. The Navy granted the deferral because of its concerns that repayment would place one or both of the contractors in a financial condition that would endanger essential defense programs.

Appendix I
Significant Events Affecting the A-12 Program

2/22/91	The Navy notified McDonnell Douglas and General Dynamics that the claim they submitted on December 31, 1990, would be considered when it was properly certified.
6/7/91	McDonnell Douglas and General Dynamics filed a lawsuit in U.S. Claims Court, asking, among other things, that the court find that the Navy breached the contract and that the termination was for the convenience of the government rather than for default. The contractors are also asking that (1) they be awarded all of their incurred costs, a reasonable profit, and settlement expenses; (2) the A-12 contract price be increased in accordance with the claim submitted on December 31, 1990, which they valued at \$1.4 billion; (3) they not be required to return \$1.35 billion in progress payments; and (4) the A-12 contract type be changed from fixed-price incentive to a cost plus fixed fee.
6/26/91	McDonnell Douglas and General Dynamics filed a termination for convenience proposal and claim with the Navy for a settlement worth between \$1.3 billion and \$1.9 billion.
8/1/91	The Legislation and National Security Subcommittee of the House Committee on Government Operations issued a subpoena to the Secretary of Defense for the February 4, 1991, A-12 deferment decision memorandum from the Acting Under Secretary of Defense for Acquisition to the Deputy Secretary of Defense. The memorandum and all attachments, endorsements, and supporting documentation were to be produced by August 9, 1991.
8/8/91	The President asserted executive privilege and instructed the Secretary of Defense not to release the memorandum subpoenaed by the Subcommittee. In announcing his decision, the President stated that the release of these documents would inhibit the candor needed by the Department of Defense to make effective decisions and recommendations concerning national security.

Appendix I
Significant Events Affecting the A-12 Program

8/9/91

The Secretary of Defense advised the Subcommittee that the President invoked executive privilege and directed that the memorandum subpoenaed on August 1, 1991, not be released.

Payments Made to McDonnell Douglas for the A-12 Program

Funding for the A-12 full-scale development contract included both research, development, test, and evaluation funds and aircraft procurement funds because the development contract included production options. The government made \$2.68 billion in progress payments to the contractors, but only \$1.33 billion was for items delivered to and accepted by the government. The remaining \$1.35 billion was for normal progress payments for work that had not been delivered at the time the contract was terminated.

The government also paid a total of \$46.4 million for 20 A-12-related orders under a basic ordering agreement. This agreement covered studies by McDonnell Douglas and General Dynamics for both the Navy and the Air Force. Navy studies included the integration of technology into the A-12 program and advanced versions of the A-12; Air Force studies included program development and risk reduction efforts for the Air Force's version of the A-12.

Table II.1 identifies the payments made to McDonnell Douglas for work on the A-12 full-scale development contract, which totaled \$1.4 billion, and for work performed under the basic ordering agreement, which totaled \$25.6 million. Table II.2 provides a description of work performed and identifies the total payments made for each order.

Table II.1: Full-Scale Development, Production, and Basic Ordering Agreement Payments to McDonnell Douglas for the A-12 Program

Date received	Full-scale development	Lot I production	Lot II production	Basic ordering agreement
1/88	\$12,144,623	0	0	0
2/88	4,124,787	0	0	0
3/88	5,044,066	0	0	0
4/88	29,399,138	0	0	0
5/88	0	0	0	0
6/88	28,655,220	0	0	0
7/88	65,084,977	0	0	0
8/88	22,379,006	0	0	\$138,023
9/88	0	0	0	0
10/88	43,651,892	0	0	0
11/88	27,127,164	0	0	0
12/88	23,014,090	0	0	0
1/89	26,734,761	0	0	0
2/89	21,256,869	0	0	0

(continued)

**Appendix II
Payments Made to McDonnell Douglas for the
A-12 Program**

Date received	Full-scale development	Lot I production	Lot II production	Basic ordering agreement
3/89	92,244,792	0	0	282,925
4/89	30,216,276	0	0	596,365
5/89	38,459,252	0	0	359,997
6/89	47,036,777	0	0	0
7/89	42,614,889	0	0	856,162
8/89	64,478,942	0	0	620,570
9/89	51,194,796	\$897,680	0	1,018,396
10/89	43,535,287	0	0	0
11/89	102,492,526	1,080,876	0	364,526
12/89	127,964,316	476,426	0	430,508
1/90	50,906,992	0	0	353,548
2/90	61,482,750	1,388,392	0	229,116
3/90	70,573,103	1,969,459	0	302,673
4/90	60,191,956	2,331,412	0	1,300,010
5/90	51,507,602	1,175,278	0	809,170
6/90	73,020,098	1,798,657	0	0
7/90	50,234,125	3,430,445	0	917,587
8/90	0	0	0	801,458
9/90	0	0	0	1,306,257
10/90	18,918,082	11,213,509	0	944,090
11/90	14,749,063	5,035,200	\$545,936	546,460
12/90	0	0	0	947,119
1/91	0	0	0	1,482,068
2/91	0	0	0	0
3/91	0	0	0	2,114,053
4/91	0	0	0	1,683,142
5/91	0	0	0	0
6/91	0	0	0	0
7/91	0	0	0	0
8/91	0	0	0	0
9/91	0	0	0	4,158,493
10/91	0	0	0	248,052
11/91	0	0	0	0
12/91	0	0	0	1,159,446
1/92	0	0	0	0
2/92	0	0	0	1,656,775
Total	\$1,400,438,217	\$30,797,334	\$545,936	\$25,626,989

**Appendix II
Payments Made to McDonnell Douglas for the
A-12 Program**

**Table II.2: Basic Ordering Agreement
and Associated Payments to McDonnell
Douglas**

Order number	Service	Amount received	Description of work
1	Navy	\$138,023	Advanced tactical aircraft advance development engineering
2	Navy	200,000	Consolidated automated support system
3	Air Force	6,192,728	Program development engineering services study
4	Navy	36,996	Millimeter and microwave monolithic integrated circuit study
5	Navy	223,370	Module interface unit development study
6	Navy	95,212	Reconnaissance program concept formulation study
7	Air Force	8,607,822	Early risk reduction
8	Navy	672,720	Additional reconnaissance program studies
9	Navy	352,738	Advanced avionics architecture study
10	Navy	2,427,200	Additional millimeter and microwave monolithic integrated circuit studies
11	Navy	244,415	Advanced avionics architecture communications, navigation, and identification study
12	Air Force	3,467,912	Early risk reduction
13	Navy	128,184	Study to incorporate Joint Integrated Avionics Working Group advanced avionics architecture communications, navigation, and identification into the A-12
14	Navy	402,114	Consolidated automated support system test program set design
15	Navy	1,406,552	Integrated diagnostic demonstration study
16	Navy	117,849	Advanced avionics architecture (electronic warfare) study
17	Navy	118,714	A-2000 concept formulation study
18	Navy	148,827	Anti-air warfare study
19	Navy	8,942	Consolidated automated support system test program set development
20	Air Force	636,671	Early risk reduction
Total		\$25,626,989	

**Appendix II
Payments Made to McDonnell Douglas for the
A-12 Program**

When the A-12 program was terminated on January 7, 1991, 11 of the 20 orders were still active; 6 of the 11 were terminated for convenience by the Navy on January 15, 1991. The remaining five orders were allowed to continue until completion.

Three of the continuing orders were risk reduction studies for the Air Force. According to Navy officials, the Air Force reduced the scope of work in these studies but completed them because the work could be applied to other Air Force programs. Orders 7 and 20 were completed on July 31, 1991; order 12 was completed on September 30, 1991.

The two remaining orders were studies for the Navy of integrated circuits and integrated diagnostics. Order 10 was a classified study on the use of advanced integrated circuit technology in the A-12 program. A Navy official stated that this work was applicable to other Navy programs and that development of the technology was continuing independently of the A-12 program. This order was completed on September 30, 1991.

Order 15, an integrated diagnostics demonstration study, was part of a larger Defense Department initiative to develop and field computer-aided logistics system technologies to improve weapon system maintainability. According to Navy officials, the integrated diagnostics demonstration study is applicable to other Navy programs, including the AX, the Navy's replacement for the A-12. The portion of the study being conducted under the A-12 basic ordering agreement will be completed in September 1992. At that time, Navy officials hope to find other funds to continue the program.

Related GAO Products

Naval Aviation: Opportunities to Apply A-12 Research, Knowledge, and Technologies (GAO/NSIAD-92-110, Mar. 19, 1992).

Naval Aviation: Changes in Naval Aviation Budgets Since A-12 Termination (GAO/NSIAD-92-46, Dec. 19, 1991).

Defense Industry: Issues Concerning Five Weapon Systems Produced or Developed by McDonnell Douglas Corporation (GAO/T-NSIAD-92-1, Oct. 3, 1991).

Deferment Actions Associated With the Navy A-12 Aircraft (GAO/T-NSIAD-91-51, July 25, 1991).

Deferment Actions Associated With the Navy A-12 Aircraft (GAO/T-NSIAD-91-50, July 24, 1991).

Naval Aviation: Status of Navy A-12 Contract and Material at Termination (GAO/NSIAD-91-261, July 24, 1991).

Information on the A-12 Default Termination (GAO/T-NSIAD-91-15, Apr. 11, 1991).

Information on the A-12 Default Termination (GAO/T-NSIAD-91-14, Apr. 9, 1991).

Naval Aviation: Navy A-12 Aircraft Funding Status (GAO/NSIAD-91-171, Mar. 22, 1991).

Navy A-12: Cost and Requirements (GAO/NSIAD-91-98, Dec. 31, 1990).

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