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BY THE COMPTROLLER GENERAL

# Report To The Congress

OF THE UNITED STATES

## Two Contracts For Nuclear Attack Submarines Modified Under Authority Of Public Law 85-804--Status As Of December 20, 1980

The 1979 Defense Appropriation Authorization Act requires the Comptroller General to review two specific contracts for SSN-688 class nuclear attack submarines.

The review is to insure that funds authorized for payments under contract modifications made in the interest of national defense are being used only on the two contracts and that the contractor does not use such funds to realize any total combined profit.

GAO found that the funds are being spent as intended and the contractor is still projecting losses.

In addition, the contractor is seeking to recover from the Navy, under insurance provisions of the contracts, costs incurred to correct defective workmanship and has submitted the first of a number of proposed claims.



PLRD-82-2

OCTOBER 20, 1981

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

B-197665

To the President of the Senate and the  
Speaker of the House of Representatives

This is our third report on the status of two contracts for SSN-688 class attack submarines modified in 1978 under the authority of Public Law 85-804. The report covers the contractor's fiscal year ended December 20, 1980.

In 1978, after years of disagreement over shipbuilding claims filed by the Electric Boat Division of the General Dynamics Corporation (see PSAD-79-107, dated Oct. 2, 1979), the Navy and the contractor agreed to a settlement based on an estimated cost at completion of \$2,668 million. The agreement was reached under a law (Public Law 85-804) that allows the President to modify contracts in the interest of national defense.

Among its terms, the settlement provided for (1) the contractor to absorb a \$359 million loss over the remaining submarine construction period, (2) the Navy to cover another \$359 million under the authority of Public Law 85-805, (3) cost overruns to be divided equally up to a total of \$100 million with costs above that figure being the total responsibility of General Dynamics, and (4) cost underruns to be shared equally.

We made our review in compliance with section 821 of the 1979 Defense Appropriation Authorization Act. Section 821 requires the Comptroller General to report annually to the Congress on the results of reviews of contracts N00024-71-C-0268 and N00024-74-C-0206, which the Navy awarded to General Dynamics. These reviews are to ensure that funds authorized to provide relief under Public Law 85-804 in the 1978 claims settlement are used only on the two contracts and that the prime contractor does not use such funds to realize any total combined profit.

We conducted our review at the Electric Boat Division of General Dynamics and at the offices of the Supervisor of Shipbuilding, Conversion and Repair, U.S. Navy in Groton, Connecticut. We discussed expenditure matters with representatives of the resident office of the Defense Contract Audit Agency (DCAA) in Groton.

We reviewed Electric Boat and Navy cost and payment records, documents, and reports pertaining to the two contracts. We also reviewed and evaluated DCAA's December 1980 audit of Electric Boat's progress payment requests for the two

contracts for the period ended December 20, 1980. DCAA audited the progress payments to ensure that the contractor was following the billing procedures agreed to in the 1978 claims settlement and that Electric Boat's share of the loss was being absorbed through reductions in progress payments.

We addressed the potential financial impact on the 1978 claims settlement to correct problems resulting from the use of unacceptable grades of steel, incomplete and unsatisfactory structural welds, and painting deficiencies which delayed the delivery of the SSN-688 class submarines. We made no attempt, however, to identify the causes or to evaluate the reasonableness of the proposed solutions to those problems. These issues are being addressed in a separate GAO review.

We found that as of Electric Boat's fiscal year ended December 20, 1980:

- Funds provided were still being used only on the specified contracts.
- Electric Boat continued to project an overall loss on the contracts and, on the basis of incurred costs through December 20, 1980, could not experience an underrun on the remaining estimated costs to become profitable.
- The contractor was overrunning the adjusted estimated cost at completion at the time of the claims settlement by about \$46 million, versus a \$3 million cost overrun as of December 1979. This leaves only \$54 million of the \$100 million maximum overrun in which both the Government and Electric Boat share equally.

After Electric Boat's fiscal year ended, certain developments occurred that could affect the estimated loss position:

- Electric Boat is seeking to recover from the Navy, under the "builder's risk" insurance provision of the contracts, the costs incurred to correct faulty workmanship by its employees. Electric Boat submitted an initial insurance reimbursement request for \$18.9 million on the SSN-698 and expects to submit additional requests on the remaining submarines already delivered or under construction.
- Electric Boat believes that it might well have a sound legal basis to submit an insurance claim to recover a portion of the \$359 million settlement loss. However, it advised a congressional subcommittee and the Navy that it would not seek such recovery under the insurance provisions of the SSN-688 class contracts.

--After the Navy decided not to award three future SSN-688 class submarines to Electric Boat, the company reexamined its contract delivery dates negotiated in the 1978 settlement and rescheduled deliveries for the last seven ships. The new delivery dates reflect delays of 4 to 9 months.

#### USE OF AUTHORIZED FUNDS

As of December 20, 1980, Electric Boat had incurred about \$150 million of costs in excess of the absorbed loss and amounts billed the Government, as shown below:

	<u>Contract</u>		<u>Total</u>
	<u>-0268</u>	<u>-0206</u>	
	------(millions)-----		
Incurring costs	\$1,051.7	\$1,159.7	\$2,211.3
Less absorbed loss	<u>132.2</u>	<u>126.2</u>	<u>258.3</u>
Adjusted costs	<u>919.5</u>	<u>1,033.5</u>	<u>1,953.0</u>
Less: Progress payments billed	866.0	904.4	1,770.4
Extraordinary escalation billed (note a)	<u>5.4</u>	<u>27.3</u>	<u>32.7</u>
Total	<u>871.4</u>	<u>931.7</u>	<u>1,803.1</u>
Unreimbursed costs	<u>\$ 48.1</u>	<u>\$ 101.8</u>	<u>\$ 149.9</u>

a/Extraordinary escalation represents the additional costs attributable solely to inflation above that included in the \$2,668 million estimated cost at completion at the time of the 1978 settlement.

The incurred costs have not been reduced by \$58 million, which DCAA considers unallowable under the Defense Acquisition Regulation. DCAA told us that \$32.5 million is subject to negotiation and \$25.5 million is subject to litigation before the Armed Services Board of Contract Appeals. Even if the entire \$58 million is disallowed, there would still be a balance of about \$92 million in unreimbursed costs. Therefore, since the amount spent on the contracts is greater than the reimbursement, the funds made available under Public Law 85-804 are not being used on business other than the two contracts.

COMBINED PROFIT/LOSS STATUS

The contractor's estimated loss at completion as of December 20, 1980, is \$382 million versus a \$359 million estimated loss after the 1978 claims settlement (see chart on p. 5). The total cost overrun during the year, before applying the cost sharing ratio, is \$46 million versus a \$3 million total cost overrun as of December 22, 1979. The terms of the settlement state that the contractor and the Government are to share the cost overruns equally up to a maximum of \$100 million. Accordingly, only \$54 million of the maximum overrun remains to which the cost sharing ratio applies.

To determine the estimated cost at completion for sharing purposes, we reduced the total estimated cost by the values for contract modifications and extraordinary escalation from January 1978 to the estimated completion date of the two contracts. We made the reduction solely for converting the total estimated cost to a basis consistent with the estimated cost at completion at the time of the 1978 settlement.

	<u>Contract</u>		<u>Total</u>
	<u>-0268</u>	<u>-0206</u>	
	----- (millions) -----		
Estimated cost at completion on December 20, 1980 (notes a and d)	\$1,062	\$1,759	\$2,821
Less: Contract modifications (notes b and e)	10	19	29
Extraordinary escalation forecast	<u>6</u>	<u>72</u>	<u>78</u>
Total	<u>16</u>	<u>91</u>	<u>107</u>
Estimated cost for sharing purposes	1,046	1,668	2,714
Estimated cost at completion at time of 1978 settlement	<u>1,009</u>	<u>1,659</u>	<u>2,668</u>
Cost overrun	<u>37</u>	<u>9</u>	<u>46</u>
Amount of overrun to be absorbed by contractor per settlement terms (50 percent) (note c)	19	4	23
Estimated loss at completion at time of 1978 settlement	<u>136</u>	<u>223</u>	<u>359</u>
Estimated loss at completion as of December 20, 1980	<u>\$ 155</u>	<u>\$ 227</u>	<u>\$ 382</u>

a/See app. I for analysis by hull number.

b/Includes \$3 million in profit.

c/Figures rounded.

d/Includes amounts involved in weld review.

e/Does not include any amount which Electric Boat may recover for the insurance reimbursement request.

The December 20, 1980, estimated cost at completion of \$2,821 million includes \$58 million of costs questioned by DCAA and a management reserve of about \$26 million established by Electric Boat for contract -0206. Electric Boat officials said this reserve represents costs which may not be incurred on the basis of current labor trends, but the reserve is not firm enough to warrant reducing the total estimated cost.

As summarized below, the expected combined loss could be between \$340 million and \$382 million, depending on whether questioned costs are disallowed and labor savings (management reserve) are realized.

	<u>Contract</u>		<u>Total</u> <u>(note a)</u>
	<u>-0268</u> <u>(note a)</u>	<u>-0206</u> <u>(note a)</u>	
------(millions)-----			
Loss before adjustments	\$155	\$227	\$382
Loss if labor savings are realized	155	214	369
Loss if questioned costs are disallowed	134	219	353
Loss if both labor savings are realized and questioned costs are disallowed	134	206	340

a/Figures rounded.

PROSPECT FOR AN OVERALL PROFIT  
ON THE COMBINED CONTRACTS

Because Electric Boat and the Navy share cost overruns equally, Electric Boat would have to underrun the total estimated cost by \$764 million to break even on the maximum estimated loss of \$382 million or by \$680 million to break even on the minimum estimated loss of \$340 million.

In our opinion, this is not possible. As of December 20, 1980, Electric Boat had incurred all but \$610 million of the total cost estimate of \$2,821 million. However, as discussed on pages 8 and 9, the impact of insurance claims could significantly affect total costs incurred and Electric Boat's profit or loss.

The total loss is also affected by change orders because Electric Boat is allowed to earn a profit on individual change orders, subject to the limitations on the use of relief funds to contribute to an overall profit on the two contracts. Adjudicated change orders in relation to total estimated construction costs, however, have not been material, amounting



to only \$24.2 million as of December 31, 1980. As of the same date, unadjudicated changes and requests for proposal totaled only \$10.5 million.

COSTS ASSOCIATED WITH DEFECTIVE  
WELDING AND OTHER PROBLEMS

In our previous report (PSAD-80-68, dated Aug. 8, 1980), we discussed construction problems of defective workmanship and materials (incomplete and unsatisfactory welds and use of non-conforming steel) that are contributing to cost growth on these contracts. Costs are continuing to be incurred to correct these problems.

Shop orders identified by Electric Boat as related to the defective welding problem represent the only data available at this time to measure the cost of this problem. As of December 20, 1980, DCAA's cost summary of these shop orders showed that costs incurred on the welding problem totaled \$47 million. After we completed our review, DCAA's cost summary showed that costs incurred have increased from \$47 million to \$61 million.

However, the Navy believes that some of these costs may not be allocable only to the defective welding problem. In conducting floor checks on two SSN-688 boats, DCAA saw other work being done. Although the potential misclassification of costs will not affect the total costs incurred under the contracts, it could have an impact on any claims under insurance provisions of the contracts (see p. 8).

In its comments to our report, Electric Boat did not agree with the DCAA findings, stating that since the audit report was issued in April 1981 for changes occurring in February 1981 and the first week of March, the company could not reconstruct DCAA's observations. Electric Boat also commented that the amounts involved were insignificant.

From June 28, 1980, to April 25, 1981, Electric Boat's incurred costs associated with the use of nonconforming steel had only increased from \$2.7 million to \$2.8 million for the SSN-688 and Trident submarine class programs, of which about \$1.9 million applied to the SSN-688 contracts. As of April 25, 1981, incurred costs for a paint problem amounted to about \$1.9 million. We consider these amounts insignificant in relation to the total estimated losses of \$340 million to \$382 million.

INSURANCE CLAIMS FOR COST OF CORRECTING  
FAULTY WORKMANSHIP COULD REDUCE ESTIMATED  
LOSS AT COMPLETION

Electric Boat is seeking to recover from the Navy, under the builder's risk insurance provision of the contracts, the costs incurred to correct faulty workmanship by its employees. Since 1942, the Navy has acted as a self-insurer of builder's risk associated with new ship construction.

Electric Boat submitted an initial insurance reimbursement request, dated June 16, 1981, to the Navy to recover \$18.9 million for costs associated with defective welding for the SSN-698 only. It is expected that this request will be followed by other requests for the SSN-699 and the remaining submarines on these contracts. According to an Electric Boat official, the requests will cover not only the direct costs associated with defective welding but also the costs of delay and disruption incidental to the problem.

Electric Boat has not decided whether it will seek insurance reimbursement for painting deficiencies, and a claim for non-conforming steel costs is dependent on the outcome of ongoing litigation against the company's suppliers.

Potential impact of insurance  
claims on estimated loss

The adjudication of the insurance reimbursement requests can significantly influence the amount of cost overrun to be absorbed by the contractor. The General Manager of Electric Boat testified before congressional committees that the total potential insurance claim, including delay and disruption costs, would not exceed \$100 million. If the claim reached that amount and the Navy honored the entire claim, the estimated loss at completion would be significantly reduced, but the prospect for making an overall profit would still be highly improbable. Further, as discussed below, the Navy does not believe that the insurance provisions cover faulty workmanship.

Navy questions insurance coverage

We were advised that the initial and anticipated insurance reimbursement requests ask, or will ask, the Navy, exclusively in the Navy's capacity as Electric Boat's insurance company, to pay for the costs incurred to correct faulty workmanship and related delay and disruption costs. Electric Boat believes that the insurance provisions of the contract protect against the occurrence of faulty work, regardless of the presence or absence of fault on the part of the insured. Further, Electric Boat argues that commercial underwriters, under current marine builder's risk

insurance policies which contain language more restrictive than that in the Navy policy, do pay for the correction of faulty workmanship.

The Navy maintains that the insurance clause and the builder's risk policy do not cover delay and disruption costs incident to a covered event or the costs to correct faulty workmanship or defective material. The Navy believes that the insurance provisions cover only loss or damage caused by an event which is fortuitous, unexpected, or accidental, such as fire, explosion, or accidental breakage. Because of these differing interpretations of coverage, a court of law may eventually have to decide the merits of the claims.

#### INSURANCE CLAIM TO RECOVER SETTLEMENT LOSS

Besides the insurance claims expected on the recent construction problems, Electric Boat, earlier this year, told the Surveys and Investigations Staff of the House Committee on Appropriations that the company might well have a sound legal basis to submit a claim to recover a portion of the \$359 million loss which it agreed to absorb as part of the 1978 claims settlement. In a February 4, 1981, memorandum to the Chairman of the House Appropriations Committee, the Investigative Staff reported that Electric Boat possessed Navy documents which stated that a large portion of Electric Boat's Public Law 85-804 cost overrun was the result of "defective workmanship." Since Electric Boat maintains that defective workmanship is covered by the insurance provided by the Government and since the Navy states that insurance was excluded from the settlement, the company believes that it may have a valid legal basis to recover part of the \$359 million on an insurance claim basis. Electric Boat officials advised the Investigative Staff that they had not made a final determination on whether to submit such an insurance claim.

After the Investigative Staff's report, Electric Boat testified before the Subcommittees of the Senate Appropriations and House Armed Services Committees. During one of these appearances, the General Manager of Electric Boat advised the Senate Defense Appropriations Subcommittee that:

"On February 20, 1981, I met with Admiral Fowler [Commander, Naval Sea Systems Command] and we agreed at that time that Electric Boat would not seek recovery under the insurance provisions of its SSN 688 class contracts of any portion of the \$359 million loss it previously agreed to absorb on these contracts."

ELECTRIC BOAT REVISES DELIVERY DATES  
FOR SHIPS UNDER CONTRACT -0206

After the Secretary of the Navy decided not to award three future SSN-688s to Electric Boat, the company reexamined its SSN-688 delivery schedules and, as of April 7, 1981, provided the Navy with revised delivery dates for the last seven ships. (See app. II.) This April rescheduling reflected delays of 4 to 13 months. According to Electric Boat, the rescheduling was required to maintain the necessary ratios of skilled tradesmen for future SSN-688 construction. Before this time, Electric Boat, according to the Navy, maintained that it would deliver these boats according to the delivery dates negotiated in the 1978 claims settlement.

Since the establishment of the revised schedule, the Navy made it clear that it desired delivery of the ships as early as possible to meet fleet operating requirements. Electric Boat agreed to study the pros and cons of the extended schedule for industrial base preservation purposes. At the same time, the company, in a July 22, 1981, letter, advised the Navy that it would conform to schedules which support an earlier delivery of the last five ships. The revised dates for these ships are reflected in the appendix II delivery schedule and now represent delays ranging from 4 to 9 months.

INCREASE IN ESTIMATED COST AT COMPLETION

For the period ended March 28, 1981, Electric Boat's estimated cost at completion for contract -0206 increased from about \$1,759 million as of December 20, 1980, to \$1,786 million--a \$27 million increase. The estimated cost at completion for contract -0268 during the same time period did not increase, since all seven ships under that contract had been delivered to the Navy. We did not attempt to determine the impact this increase will have on the estimated cost overrun.

ELECTRIC BOAT, NAVY, AND DCAA COMMENTS

Electric Boat provided comments (see app. III) that basically recommended changes to the report. These changes and comments are reflected in the appropriate report sections.

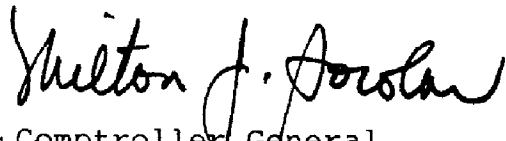
Electric Boat also noted that, overall, our report goes beyond the clearly stated requirement and purpose (of its statutory charter) as presented on the report cover sheet. In this regard, while section 821 of Public Law 95-485 requires that certain review objectives be accomplished in connection with specified contracts, we believe that our audit authority and responsibilities clearly extend to reporting on any significant developments affecting these contracts.

The Navy submitted updated delivery data but otherwise had no comments on the report (see app. IV).

DCAA found the report essentially accurate regarding its involvement and provided some clarification and additional information (see app. V).

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We are sending copies of this report to the Chairmen, Senate and House Committees on Armed Services; Senator William Proxmire; and the Chairman, General Dynamics Corporation.



Acting Comptroller General  
of the United States



ESTIMATED COST AT COMPLETION

(DEC. 20, 1980)

<u>Contract and hull number</u>	<u>Incurred (note a)</u>	<u>Estimate to complete</u>	<u>Estimate at completion (note a)</u>
----- (millions) -----			
-0268:			
690	\$ 178	\$ 0	\$ 178
692	136	1	137
694	135	1	136
696	144	1	145
697	141	0	141
698	162	3	165
699	<u>156</u>	<u>4</u>	<u>160</u>
Total	<u>1,052</u>	<u>10</u>	<u>1,062</u>
-0206:			
700	200	6	206
701	147	12	159
702	138	19	157
703	128	27	155
704	121	33	154
705	101	55	156
706	88	68	156
707	77	82	159
708	64	99	163
709	53	113	166
710	<u>43</u>	<u>125</u>	<u>168</u>
Total	<u>1,160</u>	<u>639</u>	b/ <u>1,759</u>
TOTAL	<u>\$2,212</u>	<u>\$649</u>	b/ <u>\$2,821</u>

a/Figures rounded.

b/The total estimate at completion, obtained by summing comparable costs by ship was \$1,800 million. For the contract, the estimate to complete was shown as \$1,759 million. According to Electric Boat, the contract estimate to complete figure is the one used for reporting purposes.

COMPARISON OF DELIVERY DATES NEGOTIATED  
UNDER PUBLIC LAW 85-804 WITH CURRENT DELIVERY DATES  
FOR SSN-688s UNDER CONTRACTS -0268 and -0206

<u>Contract and hull number</u>	<u>Delivery dates</u>	
	<u>Public Law 85-804</u>	<u>Current</u>
<b>-0268:</b>		
SSN 690	6-10-77	<u>a/</u> 6-10-77
692	3-10-78	<u>a/</u> 3-10-78
694	6-09-78	<u>a/</u> 6-09-78
696	3-31-79	<u>a/</u> 1-23-79
697	8-04-79	<u>a/</u> 11-30-79
698	10-27-79	<u>a/</u> 2-13-81
699	2-23-80	<u>a/</u> 3-31-81
<b>-0206:</b>		
SSN 700	6-21-80	<u>a/</u> 6-26-81
701	10-18-80	<u>b/</u> 10-02-81
702	2-14-81	<u>b/</u> 11-14-81
703	6-13-81	<u>b/</u> 12-22-81
704	2-06-82	<u>b/</u> 6-26-82
705	6-05-82	<u>b/</u> 12-24-82
706	10-02-82	<u>c/</u> 5-83
707	1-29-83	<u>c/</u> 10-83
708	9-24-83	<u>c/</u> 3-84
709	1-21-84	<u>c/</u> 9-84
710	5-19-84	<u>c/</u> 2-85

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a/Actual.

b/As of April 7, 1981.

c/As of July 22, 1981.



**GENERAL DYNAMICS*****Electric Boat Division***

Eastern Point Road, Groton, Connecticut 06340

Date: August 21, 1981

Subject: General Accounting Office (GAO) Draft Report on  
"Two Contracts for Nuclear Attack Submarines  
Modified Under Authority of Public Law 85-804 --  
Status as of December 20, 1980"

Reference: (a) United States General Accounting Office  
Letter (Mr. Donald J. Horan) to Electric Boat  
Division (Mr. L. E. Holt), dated July 14, 1981,  
same subject

Mr. Donald J. Horan, Director  
Procurement, Logistics and  
Readiness Division  
United States General Accounting Office  
Washington, D. C. 20548

Dear Mr. Horan:

Electric Boat Division has received and reviewed the draft GAO audit report entitled "Two Contracts for Nuclear Attack Submarines Modified Under Authority of Public Law 85-804 -- Status as of December 20, 1980". As requested in Reference (a), the following Electric Boat Division comments are provided.

COMBINED PROFIT/LOSS POSITION

The following note (d) should be added to the schedule on page 5, "Cost at Completion includes amounts involved in weld review program. However, the figures shown as "contract modifications" do not include any amount which Electric Boat may recover for the insurance reimbursement request."

COST ASSOCIATED WITH DEFECTIVE WELDING AND OTHER PROBLEMS

The report on page 8 refers to a DCAA floor check of time charges and identifies a potential misclassification of costs. The Division does not concur in these findings and since the audit report was issued in April 1981 for charges occurring in February 1981 and the first week of March, it is not possible for the Contractor to reconstruct the DCAA's observations. We do not believe the DCAA findings to be accurate, but in any event, the amounts involved are insignificant.

GAO note: Page references in this appendix refer to the draft report and do not necessarily agree with the page numbers in the final report.

**GENERAL DYNAMICS*****Electric Boat Division***

Mr. Donald J. Horan  
Page Two  
August 21, 1981

**INSURANCE CLAIM TO RECOVER SETTLEMENT LOSS**

The first sentence on page 11 of this section is not an accurate one and should be revised to read:

"... , Electric Boat, earlier this year, told the Surveys and Investigations Staff of the House Appropriation Committee that it might well have a sound legal basis to submit a claim to recover a portion of the \$359 million loss it agreed to absorb..."

Also further in the same paragraph it should read:

"...Electric Boat feels that it may have a valid legal basis to recover part of the \$359 million on an insurance claim basis."

In the next paragraph on page 11 your report, to be correct, should be revised as follows:

"Subsequent to the Investigative Staff's report, Electric Boat testified before Subcommittees of the Senate Appropriations and House Armed Services Committee. During one of these appearances, the General Manager advised the Senate Defense Appropriations Subcommittee as follows: 'On February 20, 1981, I met with Admiral Fowler and we agreed at that time that Electric Boat would not seek recovery under the insurance provisions of its SSN 688 Class contracts of any portion of the \$359 million loss it previously agreed to absorb on those contracts.'"

We request that the last sentence in this section which reads: "Its adjudication could conceivably eliminate the estimated loss on these contracts" be deleted from the report since it is not an accurate statement.

**GENERAL DYNAMICS*****Electric Boat Division***

Mr. Donald J. Horan  
Page Three  
August 21, 1981

ELECTRIC BOAT REVISES DELIVERY DATES FOR SHIPS UNDER CONTRACT - 0206

The Electric Boat Division (P. T. Veliotis) letter of July 22, 1981 to the Naval Sea System Command (VADM E. B. Fowler) on the subject of SSN 688 Class delivery schedules identifies schedules that the Division is working to meet and states Electric Boat's concern regarding the preservation of its industrial base. A copy of that letter is enclosed.

APPENDIX II - COMPARISON OF DELIVERY DATES NEGOTIATED UNDER PUBLIC LAW 85-804 WITH CURRENT DELIVERY DATES FOR SSN 688'S UNDER CONTRACTS - 0268 AND 0206

Dallas (SSN 700) was delivered to the United States Navy on June 26, 1981 by Electric Boat Division and is the third SSN 688 submarine delivered by the Division in 1981. Your final report should reflect this actual date.

Note that overall the GAO Report goes beyond the clearly stated requirement and purpose as presented on the cover sheet of the GAO report, that is:

"The Defense Appropriation Authorization Act of 1979 requires the Comptroller General to audit and review two specific contracts for SSN 688 class nuclear attack submarines.

The purpose of the audit is to ensure that funds authorized for payments under contract modifications made in the interest of national defense are being used only on the two contracts and that the contractor is not realizing any total combined profit on these contracts." Underlining added.

The Division expects that you will make the above-noted changes to your report to more clearly and accurately present the status of "Two Contracts for Nuclear Attack Submarines Modified Under Authority of Public Law 85-804 - Status as of December 20, 1980". It is also requested that a copy of this letter with the enclosure be included with your final report submittal to the Congress.

Very truly yours,

GENERAL DYNAMICS  
Electric Boat Division

  
L. E. Holt

Assistant General Manager  
Public Affairs

Enclosure

**GENERAL DYNAMICS*****Electric Boat Division****Eastern Point Road, Groton, Connecticut 06340*

File No.: PTV-810703

July 22, 1981

SUBJECT: SSN 688 Class Delivery Schedules

VADM Earl B. Fowler, USN  
Commander, Naval Sea Systems Command  
Department of the Navy  
Washington, D.C. 20362

Dear Admiral Fowler:

On April 9, 1981, Electric Boat advised the Navy of its revised schedules for delivery of the remaining SSN 688 Class submarines under construction at this shipyard. As subsequently discussed at our meeting on June 2, 1981, and in our letter of June 24, 1981, this schedule included a delivery stretchout aggregating a total of approximately thirty ship months for purposes of industrial base preservation and to minimize the adverse effects experienced when a shipyard is forced to undergo extensive layoffs followed by a rapid buildup of its work force.

These thirty ship months were included in our revised schedule on the basis of the following major assumptions: (1) that preservation of the industrial base for submarine construction was a matter of high priority to the Navy, since the Navy had cancelled the competitive procurement for SSN 688 Class submarines and had decided to award three to Newport News in order to preserve that company's industrial base for submarine construction; and (2) that the remaining SSN 688 Class submarine of the FY 80-81 procurement would be awarded to Electric Boat in June, 1981 for delivery in December, 1986 and the stretchout would therefore result in an orderly construction program involving deliveries at regular six-month intervals. We believed that revised schedule was in the best interests of both the Navy and the company.

Since establishment of our revised schedule for SSN 688 Class deliveries, the Navy has made it clear, most recently at the meeting between Secretary Lehman and Mr. Lewis on June 29, 1981 that it desires delivery of these ships as early as possible in order to meet fleet operating requirements and that these needs override considerations of industrial base preservation. In addition, since the remaining SSN 688 Class submarine was not awarded to Electric Boat in June, 1981, and since the timing of this event remains indefinite, the other major assumption underlying the stretchout aspect of our revised schedule is no longer correct.

**GENERAL DYNAMICS*****Electric Boat Division***

VADM Earl B. Fowler, USN

July 22, 1981

In view of these circumstances, Mr. Lewis advised Secretary Lehman at the meeting on June 29, 1981 that, during the remainder of this year, we would undertake a study of the pros and cons of schedule stretchout for industrial base preservation purposes in the light of various alternative scenarios to be provided by the Navy regarding numbers, types and timing of future submarine awards to Electric Boat. In the meantime, we would work to schedules which support an earlier delivery of SSN 706 through SSN 720 as follows:

<u>SSN</u>	<u>Delivery</u>
706	May 1983
707	October 1983
708	March 1984
709	September 1984
710	February 1985
719	June 1985
720	November 1985

We would appreciate it if you would provide us with the various alternative scenarios regarding numbers, types and timing of future submarine awards to Electric Boat which should be used by us in conducting the above-mentioned study. If the results of the study indicate that, under the then-existing circumstances, major benefits would be achieved by some stretchout of the SSN 688 Class schedules beyond the dates set forth above, it would be our intention to review these results with the Navy and then mutually consider the proper course of action to be taken.

Sincerely,




---

P. T. Veliotis  
General Manager

cc: Supervisor of Shipbuilding  
Conversion and Repair, USN  
Groton, CT 06340



DEPARTMENT OF THE NAVY  
NAVAL SEA SYSTEMS COMMAND  
WASHINGTON, D. C. 20382

IN REPLY REFER TO

01H2/JFR  
Ser 134

8 AUG 1981

From: Commander, Naval Sea Systems Command  
To: Chief of Naval Material

Subj: GAO Draft Report on Two Contracts for Nuclear Attack Submarines  
Modified Under Authority of Public Law 85-804--Status as of  
December 20, 1980 (OSD Case #5741)

Ref: (a) CNM Letter MAT 01C1/RJL of 22 July 1981

Encl: (1) Appendix II showing updated delivery information

1. In response to reference (a), NAVSEA has reviewed subject report and has no comments. Enclosure (1) provides updated delivery data.

Copy to:  
CHNAVMAT (MAT-01C)  
NAVCOMPT (NCB-532)  
CNO (OP-02A)

F. C. PASQUINELLI  
CAPT USN  
DIRECTOR, OFFICE OF  
INTERNAL REVIEW

Comparison of Delivery Dates Negotiated  
Under Public Law 85-804 With Current Delivery Dates  
For SSN 688s Under Contracts -0268 and -0206

<u>Contract and Hull Number</u>	<u>Delivery Dates</u>	
	<u>P.L. 85-804</u>	<u>Current 1/</u>
<b>-0268:</b>		
SSN 690	6-10-77	6-10-77 2/
692	3-10-78	3-10-78 2/
694	6-09-78	6-09-78 2/
696	3-31-79	1-23-79 2/
697	8-04-79	11-30-79 2/
698	10-27-79	2-13-81 2/
699	2-23-80	3-31-81 2/
<b>-0206:</b>		
SSN 700	6-21-80	6-26-81 2/
701	10-18-80	10-02-81
702	2-14-81	11-14-81
703	6-13-81	12-22-81
704	2-06-82	6-26-82
705	6-05-82	12-24-82
706	10-02-82	5-83
707	1-29-83	10-83
708	9-24-83	3-84
709	1-21-84	9-84
710	5-19-84	2-85

1/ As of April 9, 1981.

2/ Actual.

Enclosure (1) to SEA 01H2/JFR  
 Ltr Ser 134 of 3 AUG 1981



**DEFENSE CONTRACT AUDIT AGENCY**  
CAMERON STATION  
ALEXANDRIA, VIRGINIA 22304

IN REPLY REFER TO

PLD/703.3

31 JUL 1981

MEMORANDUM FOR HEADQUARTERS NAVAL MATERIAL COMMAND

ATTENTION: Mr. E. E. Holloway, GAO Reports Coordinator

SUBJECT: GAO Draft Report Dated 14 July 1981, "Two Contracts for Nuclear Attack Submarines Modified Under Authority of Public Law 85-804 - - Status as of 20 December 1980" GAO Code 942002 (OSD Case #5741)

We have reviewed the contents of the referenced GAO draft report and find it to be essentially accurate with respect to DCAA involvement. However, we believe three GAO statements need clarification:

a. Page One - Last Sentence: DCAA review of progress payment requests submitted under the subject contracts is not performed annually. They are performed periodically during the year. Three reviews were performed during CY 1980. The GAO report should indicate it looked at the DCAA's 22 December 1980 invoices review.

b. Page Four - First Sentence: The DCAA review of the contractor's 22 December 1980 invoices resulted in questioned costs of \$60.3 million. The GAO report addresses \$58 million of DCAA costs questioned but does not address the \$2.3 million of accrued liabilities which were not paid at the time of the progress payment request. The GAO figure is proper for consideration of costs from a contract completion stance; however, the reported costs questioned was actually \$60.3 million.

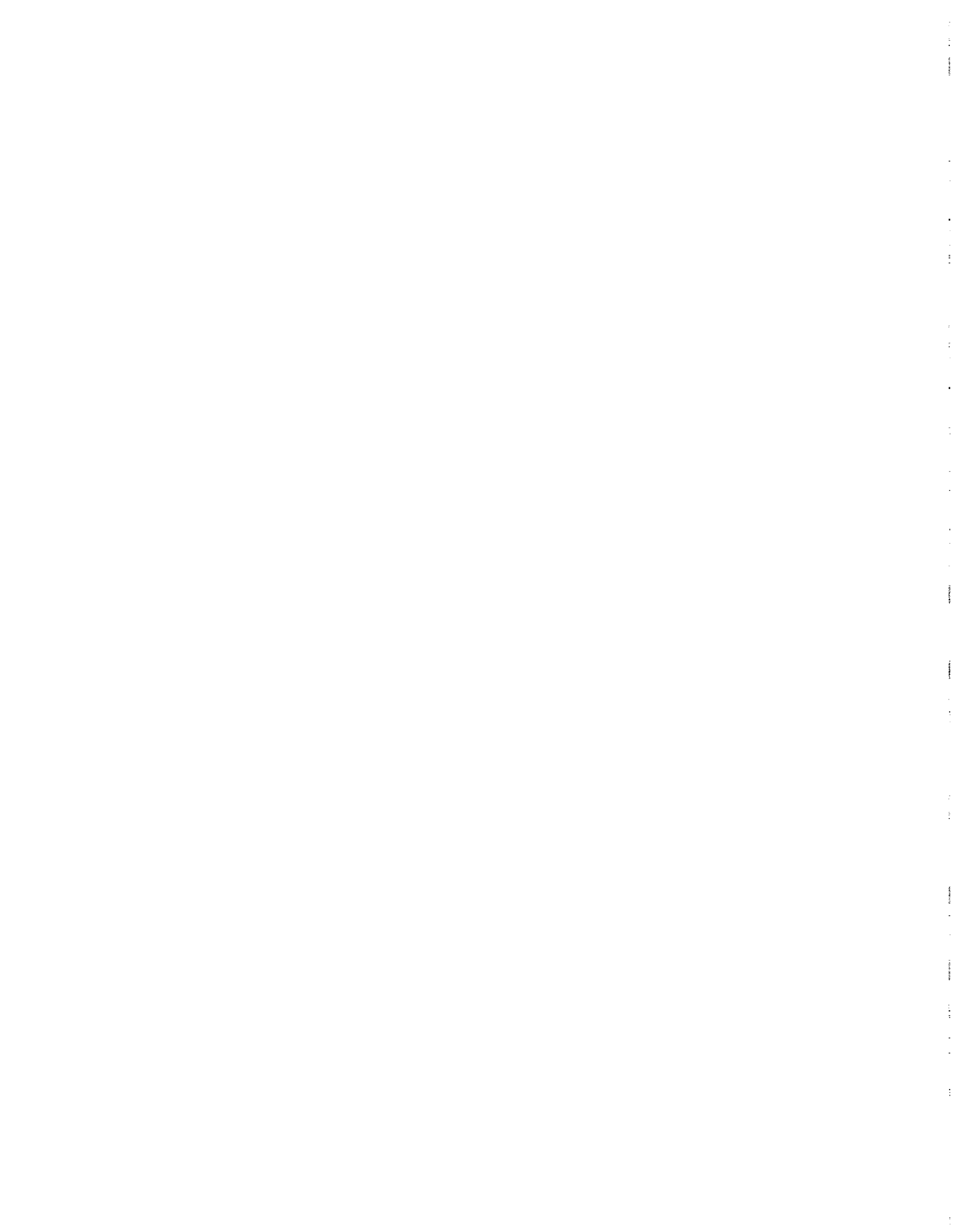
c. Page Four - Second Sentence: Of the \$58 million referred to above, the contractor is permitted by agreement with the Contracting Officer to bill the Government the \$25.5 million in costs under litigation, pending the outcome of the case.

If you have any questions regarding this memorandum, or require further information, please contact Mr. Gary Neil, Program Manager, Policy Liaison Division, 274-7521.

FOR THE DIRECTOR:

*Ray E. Logsdon*  
RAY E. LOGSDON  
Assistant Director  
Policy and Plans





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