

GAO

Report to the Chairman, Legislation
and National Security Subcommittee,
Committee on Government Operations,
House of Representatives

March 1992

NAVAL AVIATION

Opportunities to Apply A-12 Research, Knowledge, and Technologies



**National Security and
International Affairs Division**

B-247515

March 19, 1992

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

Dear Mr. Chairman:

As we reported to you earlier,¹ the Navy made progress payments on A-12 assets² in the possession of the contractors that had not been accepted by the government at contract termination. We also reported that members of the A-12 contractor team, McDonnell Douglas and General Dynamics, planned to sell these assets to outside parties and had transferred some A-12 assets to other government contracts.

We asked the Secretary of Defense about the ownership and transfer of A-12 assets and about actions he was taking to preserve the government's investment in these assets. This report discusses the Department of Defense's (DOD) response, other recent actions taken by the contractors and DOD, and whether the government's investment in these assets is protected. We also discuss potential opportunities the Navy may have to use the technologies and knowledge developed for the A-12 program.

Results in Brief

DOD's position on whether it would control the contractors' disposition of A-12 assets has changed. Before June 18, 1991, the Navy did not plan to control the contractors' disposal of A-12 assets; consequently, the contractors disposed of some assets. On that date, the Navy modified this position and notified the contractors that they must submit asset disposition plans for approval. Further, the Navy told the contractors that it must specifically approve any asset disposal. The Navy believes the

¹Naval Aviation: Status of Navy A-12 Contract and Material at Termination (GAO/NSIAD-91-261, July 24, 1991).

²Assets referred to are technologies related to stealth and manufacturing, mission planning, and covert penetration as well as common equipment, test stands, raw materials, and other assets used or produced for the A-12 program.

government owns all A-12 assets it paid for and accepted and can buy the remaining A-12 assets.

Although the Navy's position has changed, General Dynamics and McDonnell Douglas continue to dispose of A-12 assets, with some being sold for salvage and some being transferred to other government programs being worked on by the two contractors. Since the contractors have not followed the Navy's June 18, 1991, guidance, the Navy cannot ensure that the contractors' asset disposition is in the government's best interest.

If the Navy waits until litigation with the contractors is settled, it may miss opportunities to use the technologies and knowledge developed for the A-12 in such areas as stealth and jet engines on other development programs. If the Navy does not take action to acquire these items, it could incur additional costs to develop the same technologies and hardware.

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. 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 Aerospace Corporations. The contract had a target price of \$4.4 billion and a ceiling price of \$4.8 billion. On January 7, 1991, the Secretary of Defense announced that the Navy had terminated the A-12 contract for default because the contractors had difficulties in executing the contract. The Navy projected that the contractors would overrun the ceiling price by \$2.7 billion. The Navy also projected that the first flight would be delayed by over 2 years.

At termination, the government had paid the contractors \$2.68 billion. The Navy had accepted six design and management reviews, for which it paid \$1.33 billion. The contractors were paid an additional \$1.35 billion for work that had been done on the A-12 contract but had not been accepted by the Navy as completed at the time of contract termination. According to Navy officials, progress was made toward building the first A-12. Both contractors had completed about 99 percent of the engineering drawings and had fabricated about 85 percent of the tools needed to manufacture A-12 parts. The contractors had manufactured a sufficient number of some parts to meet the requirements for the first 14 aircraft.

On February 5, 1991, the Navy demanded that the contractors repay the balance of the payments, \$1.35 billion, since no additional assets had been accepted. On that same date, the government granted a deferral of the \$1.35 billion, as requested by the contractors, based on concerns that repayment would place one or both of the contractors in a financial condition that would endanger essential defense programs.

On June 7, 1991, the contractors filed a lawsuit in U.S. Claims Court asking, among other things, for a judgment changing the termination for default to a termination for the convenience of the government. In addition, the contractors want the court to bar the government from collecting the \$1.35 billion.

According to the Navy, if the court rules that the termination was for the convenience of the government, the contractors might not be required to return the \$1.35 billion in excess progress payments, and any A-12 assets being held by the contractors could be turned over to the government. If the court upholds the government's actions, however, the contractors would have to repay the \$1.35 billion, but would be able to retain the assets.

The Navy's Position on Asset Disposition Has Changed

According to Navy officials, they could have required the contractors to transfer A-12 work and materials to the government under provisions of the contract's default clause. Before June 18, 1991, the Navy did not plan to control the contractors' sale or disposal of A-12 assets. In fact, the Defense Logistics Agency's February 15, 1991, letter to General Dynamics stated that under a termination for default, the prime contractors were free to dispose of the materials at their discretion. On June 18, 1991, the Navy modified its position and notified the contractors that it must approve all asset dispositions in advance.

According to a Navy contracting official, the Navy was concerned that Navy actions to control A-12 assets could be viewed by the court as actions consistent with a termination for the convenience of the government. The Navy changed this position in the belief that under a termination for default, the government has rights to the A-12 assets and wanted to protect these rights.

In a July 22, 1991, letter to the Secretary of Defense, we asked about DOD's views on these A-12 assets. The Navy replied on September 25, 1991, that under the default clause of the contract, the government could obtain any

assets the contractors specifically produced or acquired for the A-12 program. The Navy believes the contractors must deliver these assets to the Navy, if it requests them to do so.

Contractors Dispose of A-12 Assets

The Navy's position is that the contractors are required to obtain its approval before disposing of any A-12 assets. Navy officials informed the contractors that the Navy would not approve any disposition of A-12 assets until the contractors had prepared an asset disposition plan and the Defense Contract Audit Agency (DCAA) had reviewed the plan.

The contractors submitted their asset disposition plans to the Navy on August 7, 1991, for review and approval. However, they did so with reservation. McDonnell Douglas submitted its plans even though it believed there was no contractual obligation to do so and the requirement was not authorized or proper in a termination for default. It believed the Navy's requirement that the contractors submit asset disposition procedures for approval was more consistent with a termination for convenience. General Dynamics submitted its procedures but notified the Navy that it would take action to unilaterally dispose of assets if the Navy failed to respond within 10 days of the government's receipt of a disposition notice.

As of February 6, 1992, the Navy had not approved the contractors' plans, nor had it approved the disposal of any specific A-12 assets. DCAA reviewed General Dynamics' disposition and tracking procedures and objected to language that characterized the A-12 contract termination as one for convenience. DCAA drafted a report on McDonnell Douglas' disposition procedures in October 1991. A final report has not been released. In the interim, the contractors continued to dispose of A-12 assets without approval, citing the need to (1) mitigate termination costs for themselves and the government and (2) supply material to their other federal work that experienced shortages. While the contractors have repeatedly notified the Navy of their intent to dispose of A-12 assets, they have not asked for the Navy's approval. Contractor notices stated that they were going to dispose of A-12 assets unless directed otherwise by the government within a specified time period, usually 15 days or less. The Navy has not responded to these individual contractor notices because it has not approved their disposition plans and cost-tracking procedures.

In August 1991, DCAA reported that McDonnell Douglas had transferred several million dollars of A-12 assets to the company's Instrumentation and Test Equipment asset account and to other contracts. The Navy also told us

that McDonnell Douglas had, on approximately 100 occasions, transferred A-12 assets, with a total value of less than \$1 million, to other government contracts. An October 1991 DCAA audit listed three examples in which General Dynamics Corporation disposed of several million dollars of A-12 assets.

A-12 Assets May Have Value to Other Development Programs

We recognize that not all A-12 assets would be useful to other government programs. However, there have been efforts on the part of the Navy and the contractor team to utilize some of the assets. For example, the Navy's AX program office contacted the A-12 contractors on January 31, 1991, to buy A-12 technologies related to stealth and manufacturing, mission planning, and covert penetration as well as equipment, test stands, and other A-12 assets. The AX program was initiated in the wake of the A-12 termination and is the planned replacement for the Navy's aging A-6 aircraft. The Navy dropped its efforts to buy A-12 assets in May 1991 because the necessary funds were removed from its fiscal year 1992 amended budget submission. Also, the Navy's F/A-18 program is interested in A-12 engines for an advanced version of the F/A-18.

The contractor team has also identified uses for A-12 assets. The contractors notified the government that A-12 assets could be used on other government programs to alleviate parts shortages or to provide other benefits. These programs include the Army's Patriot program, the Air Force's F-15 and F-16 programs, and the Navy's F/A-18, F-14, A-6, T-45, EA-6B, and S-3 programs. The Navy, however, did not authorize these transfers.

Recommendation

We recommend that the Secretary of the Navy immediately identify the assets that have value to other programs and, in accordance with the contract's default clause, require the contractors to deliver those assets to the Navy. The Navy should work with the contractors to reach agreement on an equitable price for these assets to be credited against the \$1.35 billion the contractors owe. The Secretary should also respond quickly to the contractors' asset disposal notices by approving or denying the requests. The Secretary should require that proceeds from such past or future sales be applied against the debt owed the government.

Scope and Methodology

To accomplish our work, we reviewed documents and interviewed Navy and contractor officials. We conducted our work from October 1991 to February 1992 in accordance with generally accepted government auditing standards. We did not obtain written agency comments on this report. However, we discussed the information in the report with Department of Defense officials and incorporated their comments where appropriate.

As arranged with your office, unless you publicly announce this report's contents earlier, we plan no further distribution of it until 30 days from its issue date. At that time, we will send copies of this report 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 other interested parties upon request.

Please contact me on (202) 275-6504 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix I.

Sincerely yours,



Martin M Ferber
Director, Navy Issues

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