COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON 25

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DEC 15 1960

Honorable F. Edward Hebert, Chairman
Subcommittee for Special Investigations
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

Your letter dated July 8, 1960, forwarded a transcript of hearings held by your Subcommittee on the recent procurement of M113 personnel carriers by the Department of the Army. In your letter you requested our opinion as to whether, in view of the provisions of 10 U. S. C. 4532(a) and any contradictions which may have occurred in the application of Bureau of the Budget Bulletin No. 60-2 to such procurement, the statute has been complied with and the expenditure of funds under the contract awarded is authorized by law.

In substance, the provisions of 10 U. S. C. 4532(a) were originally enacted in 1920 as part of section 5, Public Law 242, 66th Congress, 41 Stat. 762, 765. The following extract from 59 Cong. Rec. 4156-4157 (1920) appears to clearly set out the intended application and effect of the provision:

"The CHAIRMAN. The Clerk will report the next committee amendment.

"The Clerk read as follows:

"Committee amendment, page 15, line 2: After the period strike out the quotation and add the following:

"'He shall cause to be manufactured or produced at the Government arsenals of the United States all such supplies or articles needed by the War Department as said arsenals are capable of manufacturing or producing: Provided, That the cost of manufacturing or producing such articles or supplies at said arsenals shall not exceed the cost if purchased in the open market. And he shall operate or cause to be operated said arsenals economically. And all orders for manufacture of material pertaining to approved projects which are placed with arsenals or other Ordnance establishments shall be considered as obligations in all respects in the same manner as provided for similar orders placed with commercial manufacturers.'

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"Mr. CALDWELL. Mr. Chairman, I offer the following amendment to the amendment.

"The Clerk read as follows:

"After the word 'arsenals,' wherever it occurs in the amendment, insert the word 'factories.'

"Mr. CALDWELL. Mr. Chairman, I offer this amendment so as to cover the case of a factory that has been recently purchased by the Government during the war and now lying idle.

"Mr. SANFORD. Would not the gentleman say 'Government-owned factories'?

"Mr. CALDWELL. I will say 'Government-owned factories.' Mr. Chairman.

"The CHAIRMAN. The Clerk will report the modified amendment.

"The Clerk read as follows:

"Insert after the word 'arsenals,' wherever it occurs in the amendment, the words 'and Government-owned factories.'

* * * * *

"Mr. SANFORD. Mr. Chairman and gentlemen of the committee, it was not my purpose to say anything about this amendment, because it seemed so clear on its face. I have to confess I have in this matter that peculiar interest that any Member has when he has some interest in his district that is to be served by an amendment. There is one of the largest Government arsenals in my district, but the public interest to be served overtops that entirely. This amendment simply provides that the Government, wherever it can do so economically, shall use these arsenals to do work usually or often done by private contractors. /Applause./ In the second place, it provides when contracts are let out to be done at Government arsenals the rule with reference to the appropriation being available only for one year shall not apply.

"The situation has been that large orders have been offered to the Watervliet Arsenal, for instance, which that arsenal could not accept because in a Government arsenal the appropriation dies at the end of the year,

and inasmuch as the contemplated job would usually take longer than that time the Government has been obliged to let the job go to some private manufacturer. But on the face of it that restriction of the law is unfair to the Government and is unfair to the arsenal. The purpose of the latter part of the amendment is to remove that restriction of the law and to make these appropriations that are allotted for work to be done at Government arsenals available the same as if the work were to be done by a private manufacturer; that is, make the appropriation available for 365 days after the fiscal year in which the money is appropriated.

"Mr. CALDWELL. The gentleman's remarks would apply equally to the great factories that have been built up during the war and are now owned by the Government?

"Mr. SANFORD. I should think so. If the gentleman has any Government-owned factories in his district I am glad of it, and he can speak up for them. I am speaking for the arsenal and the vast public interests involved there.

"Mr. GARRETT. One of the provisions of the gentleman's amendment is the appropriation does not extend beyond the period of two years?

"Mr. SANFORD. It does not. The wording of the amendment is that it shall be allotted on the same terms as if the contract were made with a private manufacturer, which would be 365 days after the fiscal year ended.

"Mr. GARRETT. What I had in mind was the constitutional provision that money for the support of the Army could not extend beyond two years.

"Mr. SANFORD. I assure the gentleman that that provision of the Constitution was kept in mind when the amendment was drawn.

"The Government has invested at Watervliet over $20,000,000; there is employed there at this time a force of highly trained mechanics gathered together from all parts of the country to meet the emergency created by the war. The arsenal is now equipped to do work of the finest grade involving that most intricate of all machine work necessary to produce modern cannon. There are about 2,500 men employed there at this time, a large part of whom the Government plans to discharge in the near future.

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"I assure you that this plant can do as high-grade machine-shop work as the Bethlehem Steel Co. or any other private concern.

"The purpose of this amendment is to compel the executive officers of the Government to have Government work done at such arsenals as this and to cease handing out appropriations to private manufacturers. It is perfect nonsense to allow such an investment as this to go to waste and at the same time turn over work to be done by contract by private manufacturers.

"Unfortunately under the provisions of the general law appropriations of money for work to be done in a Government plant lapses at the end of the fiscal year for which the appropriation is made. This amendment removes the restriction and continues the appropriation for an additional year. This limitation of law has often compelled the Ordnance Department to turn work over to private manufacturers.

"I, therefore, plead with you to pass this amendment not only because of the special interest I have because of my district, but because of the greater public interest that will be directly served by the amendment.

"The CHAIRMAN. The question is on agreeing to the amendment to the amendment offered by the gentleman from New York.

"The question was taken, and the amendment to the amendment was agreed to.

"The CHAIRMAN. The question is on agreeing to the amendment of the gentleman from California as amended.

"The question was taken, and the amendment as amended was agreed to."

The language of the amendment, as quoted above, was apparently amended in conference (59 Cong. Rec. 7815; 1920) to read, in pertinent part, as follows:

"* * * He [the Assistant Secretary of War] shall cause to be manufactured or produced at the Government arsenals or Government-owned factories of the United States all such supplies or articles needed by the War Department as said arsenals or Government-owned factories are capable of manufacturing or producing upon an economical basis. * * *"

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We have been unable to find any indication that the language changes so instituted were intended to effect any change in the purpose of this provision as set out in the discussion, quoted above, following introduction of the original amendment. As amended, the language was enacted as part of section 5a of the National Defense Act of 1916. See Public Law 242, 66th Congress, 41 Stat. 759, 765.

For the purpose of your inquiry it would appear to be proper at this point to discuss the intent and purpose, as established by the foregoing legislative history, of several of the provisions of section 5a of the National Defense Act of 1916, as amended by Public Law 242, 66th Congress.

First, it is our opinion that the word "shall" was intended to make it mandatory upon the War Department to use Government arsenals and Government-owned factories to manufacture or produce all of its needs which could be so manufactured or produced on an economical basis.

Second, in the absence of a contrary expression of intention in the legislative history, it is our opinion that the words "Government-owned factories" must be interpreted to include both Government-owned Government-operated, and Government-owned contractor-operated, industrial facilities.

Third, the basic concept of the statute would appear to be a requirement that Government-owned industrial facilities should not be permitted to lie idle if it would be possible to use such facilities to produce the needs of the War Department at a cost to the Government no greater than the cost of procuring such needs from private industry. It is therefore our opinion that the phrase "capable of manufacturing or producing" was not intended to limit the statute's application to industrial facilities which were sufficiently equipped and manned to manufacture or produce the supplies or articles needed without additional equipment or personnel. We therefore believe that a proper implementation of the statute requires consideration of the use of Government-owned industrial facilities which, although not immediately capable of producing a needed article, can be adapted to production on an economical basis.

Fourth, it is our opinion that the words "economical basis" were intended to require a comparison of all costs incurred by the Government as a result of producing an article in Government-owned facilities, with the price at which the article could be purchased from a private manufacturer.

Consequently, it is our further opinion that, in determining under this statute whether an article could have been produced in a Government-owned facility on an "economical basis," it would have been improper to include in the evaluation of such cost any amount which did not represent

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an actual expenditure by, or loss of savings to, the Government which was directly attributable to such production.

Returning to an examination of subsequent amendments of the law, section 2 of Public Law 891, 76th Congress, 54 Stat. 1224 (1940), amended section 5a of the National Defense Act of 1916 in pertinent part by substituting the words "the Secretary of War" for the word "He" in the prior law.

In 1950, except to the extent of its applicability to the Air Force by virtue of the National Security Act of 1947, 61 Stat. 495, section 5a of the National Defense Act of 1916 was repealed by section 401(a) of the Army Organization Act of 1950, Public Law 581, 81st Congress, 64 Stat. 271. However, that portion of section 5a pertaining to use of arsenals and Government-owned factories was reenacted as section 101(e) of Public Law 581, 64 Stat. 264, in the following form:

> "(e) Except as otherwise prescribed by law, the Secretary of the Army shall cause to be manufactured or produced at the Government arsenals or Government-owned factories of the United States all those supplies needed by the Army which can be manufactured or produced upon an economical basis at such arsenals or factories." (Underscoring supplied.)

The intent of this reenactment is explained as follows at page 5 of Senate Report No. 1776 to accompany S. 3691, 81st Congress:

> "(e) Use of Government arsenals or Government-owned factories.------This subsection is in effect a reenactment of a similar provision contained in section 5a of the National Defense Act of 1916 with respect to use of Government arsenals and Government-owned factories."

It is further clarified at page 13, House Report No. 2110 to accompany H. R. 8198, 81st Congress, by the following:

> "Subsection 101(b), (c), and (e) are in substance restatements of provisions of existing law which will be repealed by this bill (sec. 5 (a), National Defense Act, as amended; 10 U.S.C. 1193, 1195). However, these subsections do not replace or modify the provisions of the Armed Services Procurement Act of 1947 (62 Stat. 21), which act applies uniformly to all of the armed services; vests authority in matters pertaining to contracts for the procurement of materials and services in the heads of the

three military departments and their respective Under and Assistant Secretaries; and authorizes them, with certain exceptions, to make delegations of that authority to officers of their respective services."

From the foregoing it would appear that, from its original enactment in 1920 until addition of the phrase "Except as otherwise prescribed by law" in section 101(e) of the Army Organization Act of 1950, there was no change in the intent, application, or substantive provision of this law, except to the extent that any provision of the Armed Services Procurement Act of 1947 might have been inconsistent therewith.

With respect to continued application of section 5a of the National Defense Act of 1916 to the Air Force, it would appear to be worthy of note that section 101(e) of the Air Force Organization Act of 1951, 65 Stat. 327, amended the language applicable to the Air Force to read as follows:

"(e) The Secretary of the Air Force may cause to be manufactured or produced at Government arsenals, depots, or Government-owned factories of the United States all those supplies needed by the Air Force which can be manufactured or produced upon an economical basis at such arsenals, depots, or factories." (Underscoring supplied.)

The purpose of this amendment is explained as follows at page 7, Senate Report No. 426 and page 8, House Report No. 9, to accompany H. R. 1726, 82d Congress:

"Subsection 101(e) is in general a limited restatement of provisions of existing law which will be repealed by this bill. The principal change is that whereas prior law made it mandatory upon the Secretary to utilize Government-owned factories or arsenals, whereever economical, this bill makes it permissive."

See also pages 30-31 and 66-72 of the Hearings on H. R. 399 before Subcommittee No. 2 of the House Committee on Armed Services for additional discussion on this point.

Section 101(e) of the Army Organization Act of 1950 was repealed in 1956 by section 53 of Public Law 1028, 84th Congress, 70A Stat. 641, 681, which codified Title 10 of the United States Code, and the codification included 10 U.S.C. 4532(a) in the following form:

"(a) The Secretary of the Army shall have supplies needed for the Department of the Army made in factories or arsenals owned by the United States, so far as those factories or arsenals can make those supplies on an economical basis."

The differences in the language appearing in section 101(e) of the Army Organization Act of 1950 from that enacted as 10 U.S.C. 4532(a) are explained at page 296 of House Report No. 970 and page 306 of Senate Report No. 2484, to accompany H. R. 7049, 84th Congress, as follows:

> "The words 'Except as otherwise provided /sic/ by law in 5:181-4(e) /5 U.S.C. 181-4(e); section 101(e) of the Army Organization Act of 1950/ are omitted, since there is no law within the scope of the exception. The word 'made' is substituted for the words 'manufactured or produced.' The words 'United States' are substituted for the word 'Government,' in 5:181-4(e). * * *"

Returning then to the Army Organization Act of 1950 to determine the effect of the phrase "unless otherwise prescribed by law," from the legislative history quoted above it is our view that the provisions of section 101(e) of the Army Organization Act of 1950 were not intended to supersede the provisions of the Armed Services Procurement Act of 1947, but rather to make it clear that, to the extent that the latter might be inconsistent with section 101(e), the provisions of the Armed Services Procurement Act would control. It is our opinion that such an inconsistency did exist, and continues to exist, in the provisions of section 2(c)(16) of the 1947 act, 10 U.S.C. 2304(a)(16), which authorize the Secretary of the Army to negotiate a contract with a particular supplier in the interest of national defense and industrial mobilization, notwithstanding the existence of other private or Government-owned production facilities. Conceivably, under certain circumstances, there might also be procurements under which it would be proper to invoke the authority to negotiate with a private producer under other subsections of 10 U.S.C. 2304(a), such as subsections (2), (3), or (14), notwithstanding the existence of Government-owned facilities capable of economically producing the product needed.

While the words "Except as otherwise prescribed by law" were omitted from the codification in 10 U.S.C. 4532(a), we believe that such words represented a substantive provision of the law and that their omission may not properly be interpreted as indicative of an intention to make that section controlling over inconsistent provisions of 10 U.S.C. 2304(a). As indicated at pages 8-9 of House Report No. 970 and pages 19-21 of Senate Report No. 2484, to accompany H. R. 7049, 84th Congress, the language changes incorporated into the codification of Title 10 are not intended, and may not be interpreted, to change the substantive law being codified. It is therefore our opinion that 10 U.S.C. 4532(a) must be read, interpreted, and applied in the same manner as though it were still preceded by the phrase "Except as otherwise prescribed by law." Even without that language, it would still be necessary to construe sections 4532(a) and 2304(a) together in such a way as to harmonize their provisions and to give effect to both so far as possible.

In view of the above, we must conclude that, unless a particular procurement of Army supplies falls within an exception prescribed by other law, the present provisions of 10 U.S.C. 4532(a) require the Secretary of the Army to have supplies needed by the Army produced in existing arsenals and Government-owned factories to the extent that such arsenals or factories can produce supplies at an overall cost to the Government which is equal to or less than the cost if manufactured in privately-owned facilities and procured from such manufacturers. It necessarily follows that unless the latest procurement of M113 personnel carriers, to which your request is directed, constitutes an exception to 10 U.S.C. 4532(a), either because this product could not be produced economically at Government-owned facilities or because production in, and procurement from privately-owned facilities was permissible under other provisions of law, the Secretary of the Army was required to have the personnel carriers produced in Government-owned facilities.

Turning then to the question whether the Army, in negotiating the contract for M113 personnel carriers, relied upon any provision of law which superseded the provisions of 10 U.S.C. 4532(a), we find that the contract was negotiated and awarded under the provisions of 10 U.S.C. 2304(a)(16). A copy of the determination and findings required by 10 U.S.C. 2310 are enclosed for your records. You will note that this is a class determination and findings covering seven contracts. Paragraph 2(a) of this document concludes that it is in the interest of national defense to have a particular producer available for furnishing the M113 personnel carrier in case of a national emergency and that negotiation is necessary to that end, while paragraph 2(b) concludes that the interest of national defense in maintaining active engineering, research and development would be subserved by such negotiation with a particular supplier. If these determinations, insofar as they pertain to RFP No. 60-37, were directed to one or more specific, identifiable, suppliers they could constitute a proper determination to negotiate contracts with such suppliers under 10 U.S.C. 2304(a)(16). See, in this connection, page 15, House Report No. 109, and page 14, Senate Report No. 571, to accompany H. R. 1366, 80th Congress, which, in part, states the use and purpose of 2304(a)(16) as follows:

> "* * * the authority will be exercised in such a way as to assure through contracting for supplies or services the preservation and development of key industries, companies, and facilities, whose atrophy or loss might prejudice national security. Placing of awards with the producers whose skills and facilities are needed cannot be guaranteed under the advertising method. To keep these firms in business at the minimum cost to the Government, it is necessary to be able to negotiate to eliminate unreasonable or unjustified charges. The extent of the exercise of the authority will depend

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essentially upon the availability of appropriated funds, as to which Congress has the controlling voice.

"The Committee recognizes that this subsection would authorize the making of contracts which might not represent the most economical procurement of the items involved. However, it is believed that the national security requires the granting of this power."

In view of the foregoing, we are unable to reconcile the determination made to support the negotiation of the instant procurement of M113 carriers under 10 U.S.C. 2304(a)(16) with the fact that unlimited opportunity was afforded established manufacturers in various industries to compete for award of the contract, without restriction as to the facilities to be used, or with the fact that price was a controlling factor in making the award.

However, with specific reference to your request for advice as to whether the expenditure of funds under the award is authorized by law, your attention is invited to 10 U.S.C. 2310 and to page 22 of House Report No. 109 and pages 19-20 of Senate Report No. 571, which indicate that determinations to negotiate under 10 U.S.C. 2304(a)(16), and contracts awarded pursuant to such negotiations, are final and not subject to invalidation or challenge by the Comptroller General or the courts. Under the circumstances, and particularly in view of our previously expressed opinion that contracts negotiated under 10 U.S.C. 2304(a)(16) may be regarded as authorized exceptions to the provisions of 10 U.S.C. 4532(a), it would appear that the negotiated award to Food Machinery and Chemical Corporation (FMC) must be recognized as a valid and binding obligation of the United States.

With respect to your expressed interest in any contradictions of the provisions of 10 U.S.C. 4532(a) which may have occurred as a result of the application of Bureau of the Budget Bulletin No. 60-2 to the procurement in question, it would appear to be necessary to consider whether it was proper to apply the provisions of Bulletin No. 60-2 to this procurement, and also whether such application, if improper, resulted in an award based upon production in private facilities when an award based upon use of the Cleveland plant would have resulted in the same, or a lesser cost, to the Government.

With respect to the question whether application of Bulletin No. 60-2 was proper, the transcript of the hearings before your Subcommittee indicates (pp. 92-93, 145-147) that the bidder's conference held by the Department of the Army on December 17, 1959, indicated the department's intention to evaluate proposals on an "out-of-pocket" cost to the Government without the inclusion of any rental factor either on use of the Cleveland facilities or on use of Government-owned facilities

in the possession of FMC. However, by memorandum dated January 22, 1960, the Assistant Secretary of Defense advised the Assistant Secretary of the Army that, in the event Government facilities (meaning the Cleveland plant) were to be used in producing the M113 personnel carriers, such use would constitute a "new start" within the meaning of Bulletin No. 60-2 (see transcript pp. 160-161).

Paragraph 3k of the Information and Instructions To Offerors which was issued with the Request for Proposals therefore advised offerors as follows:

> "k. Prospective suppliers are advised that any procurement under Option II of this RFP may constitute a 'new start' of a Government owned plant within the meaning of Bureau of the Budget (BOB) Bulletin No. 60-2 dated 21 September 1959. Consequently, before any award may be made under Option II, it may be necessary that any proposed activation of the Cleveland Ordnance Plant for this purpose be reported to and prior approval obtained from the Department of Defense. Hence the right is reserved for rejection of any Option II proposal solely pursuant to the requirements of BOB Bulletin. Copy of BOB Bulletin No. 60-2 is forwarded herewith for information and guidance of any prospective offeror."

Paragraph 2 of Bulletin No. 60-2 states "the general policy of the administration that the Federal Government will not start or carry on any commercial-industrial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels."

Paragraph 4 of the Bulletin requires an evaluation of and report on existing commercial-industrial facilities, while paragraph 5 requires discontinuance of activities which are not authorized as an exception to the general policy because of the existence of one of the compelling reasons (national security, cost differences, or clear unfeasibility) set out in paragraph 3.

Paragraph 6 of the Bulletin requires "proposed starts" to be subjected to the same review outlined for the evaluation of existing activities, and further provides that no new commercial-industrial activity shall be started until the responsible official has made a formal finding for the record that, due to one of the compelling reasons stated in paragraph 3, Government provision of the product or service is in the public interest.

In effect, therefore, the memorandum dated January 22, 1960, from the Assistant Secretary of Defense required the Army, prior to awarding

a contract based upon use of the Cleveland plant, to regard activation of the plant as the "proposed start" of a new commercial-industrial activity within the meaning of paragraphs 2 and 6 of Bulletin No. 60-2; to review and evaluate the necessity for starting such new activity; and to justify the proposed start under one of the compelling reasons set out in paragraph 3 of the Bulletin for making an exception to the general policy against new starts.

Apparently in implementation of that portion of paragraph 3B of the Bulletin which requires the evaluation of cost of production in Government-owned facilities to include elements such as depreciation, interest on the Government's investment, cost of self-insurance, and exemption from Federal, State, and local taxes, paragraph 3(d) of the Information and Instructions To Offerors provided that an amount calculated as a reasonable rental charge (which would include consideration of taxes, depreciation, insurance, and other factors normally included in rental rates for industrial property) would be added to offers proposing to use the Cleveland plant, or other Government-owned plants, for the purpose of evaluating such offers. By Amendment No. 1 dated March 10, 1960, to the Request for Proposals, offerors were advised that the rental factor to be used in the evaluation of offers proposing to use the Cleveland plant had been established at $.0555 per square foot per month for a period of 19 months for all floor space utilized in manufacturing, storage and direct production support. This equalization factor was based on an appraisal made by the Cleveland Real Estate Board plus an amount representing equivalent real estate taxes (transcript pp. 200-201). Paragraph 3b of the Information and Instructions To Offerors under RFP No. 60-37 also advised that this rental charge would include depreciation, insurance, and any other factors normally included in rental rates for industrial property.

To the extent that Bulletin No. 60-2 contemplates that agencies will dispose of Government-owned facilities when retention of such facilities cannot be justified because of national security, because it is clearly unfeasible to procure a product from private enterprise, or because the cost of retention and production in Government facilities exceeds the cost of procurement from private enterprise, it would appear that there is substantial justification for including indirect cost factors such as depreciation, interest on the Government's investment, and cost of self-insurance, in determining the cost of production in a Government-owned plant. Thus, where a choice must be made as to whether a Government-owned plant is to be used for production or whether the plant is to be sold, a decision to sell the plant at the beginning, rather than the end, of the production period may reasonably be expected to result in depreciation savings, self-insurance savings, and savings representing interest on the Government's investment, for the period of production. However, the same is not true where, regardless of whether it is determined that an article shall be produced in Government plant

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or purchased from private enterprise, there is no intention to dispose of the Government plant prior to the end of the production period. Under such circumstances, depreciation continues (except to the extent it may be accelerated or decelerated by use) during the production period, the cost of self-insurance continues, and no saving representing interest on the Government's investment accrues. Thus, while we have no disagreement with application of these provisions of Bulletin No. 60-2 for the purpose of determining whether a Government plant should be disposed of because production in such plant is uneconomical, we see no justification for their application where the agency expects to retain the Government plant even if it is not to be put to productive use in a contemplated procurement.

In the instant case we have found no indication that retention of the Cleveland plant by the Department of the Army was dependent upon its use in production of the M113 armored personnel carriers in question, and the fact that savings in the Government's maintenance costs on the Cleveland plant during the production period were a factor in evaluating the Cadillac proposal would appear to substantiate the conclusion that the Cleveland plant was intended to be retained by the Department of the Army during that period.

While the effect of the determination to negotiate a contract under 2304(a)(16) was to render the provisions of section 4532(a) inapplicable, we are of the opinion that to the extent the provisions of Bulletin No 60-2 required the addition to offers proposing use of the Cleveland plant of amounts representing such charges as depreciation, interest, and taxes, and to the extent that paragraphs 3B and 6 of Bulletin No. 60-2 require the cost of procurement from private enterprise to be substantially and disproportionately higher than the cost of production in the Cleveland plant before use of the Cleveland plant would be authorized, their inclusion in RFP No. 60-37 was improper. We are today advising the Secretary of Defense and the Secretary of the Army to that effect.

In this connection, we are enclosing a copy of our letter dated August 1, 1960, directing certain questions arising out of this procurement to the Director, Bureau of the Budget. We are also enclosing a copy of the Director's reply dated September 30, 1960, and copies of the letters to Senator Hart and Congressman O'Hara which are referred to in such reply. From this correspondence it would appear that the Bureau of the Budget takes no position on the question whether 10 U.S.C. 4532(a) imposes requirements which are in conflict with Bulletin No. 60-2, but advises that such determination is to be left to the procuring agency, which is directed by section 5 of Bulletin No. 60-2 to request amendatory legislation in the event of conflict.

Your attention is invited to that portion of the Director's letter which refers to the words "economical basis" in 10 U.S.C. 4532(a) and

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expresses a belief that the determination of what is "economical" from the Government's standpoint, if limited to those items chargeable to current appropriations, would be contrary to the views expressed by this Office in establishing accounting principles and standards for Government agencies. Apparently, this reference is to portions of the Accounting Principles and Standards, set out in the GAO Manual for Guidance of Federal Agencies, which indicate that agency accounting systems should include provisions for the recording of indirect costs of operation or production, such as depreciation of fixed assets (2 GAO 1270.60), which are not chargeable to current appropriations. While we are in agreement with the belief expressed by the Bureau of the Budget that the determination of cost of production in Government plant under 10 U.S.C. 4532(a) need not be limited to costs chargeable to current appropriations, we cannot agree that where, as in the instant case, continued possession of a Government plant is not contingent upon its use in production of articles to be procured, all of the indirect costs prescribed by Bulletin No. 60-2 represent proper cost factors to be considered in determining whether the articles can be produced in such plant on an economical basis, as required by 10 U.S.C. 4532(a).

With respect to the question whether application of Bulletin No. 60-2 to RFP No. 60-37 resulted in an award for production in private facilities at a higher cost to the Government than the cost of production in the Cleveland plant, it should be noted that 10 U.S.C. 4532(a) does not prescribe a method or methods to be used in determining whether production in Government arsenals or factories can be accomplished on an economical basis. However, we see no reason why such determination in the instant case should not have been based upon a proper comparison of bid prices. The record of this procurement indicates that the offer of Cadillac Motor Car Division, General Motors Corporation, was the only offer based upon the use of the Cleveland plant. This offer proposed a fixed-price (including price redetermination) of $54,477,093.23 on Items 1, 2, and 3 of the request for proposals, plus a cost reimbursable (no fee) price of $5,604,650 on Items 4 through 9, for a total price of $60,081,743.23 prior to the addition or subtraction of any bid evaluation factors such as first destination transportation costs, rental of Government-owned plant and Government-owned production equipment, cost of special tooling, and anticipated maintenance savings. Application of these evaluation factors resulted in an evaluated bid price of $64,209,765.80 (transcript p. 225).

The offer submitted by Food Machinery and Chemical Corporation (FMC) proposed production in the offeror's own plant for a fixed price (including price redetermination) of $37,522,047.64 for Items 1, 2, and 3, and indicated no cost reimbursement would be required under Items 4 through 8 (Item 9 applied to maintenance at the Cleveland plant only). Application of first destination transportation costs, rental of Government-owned plant and production equipment, cost of special tooling, and related cost savings to accrue on another contract, resulted in an evaluated bid bid price of $39,751,015.64 (transcript p. 222).

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While we are not in complete agreement with the factors used in the evaluation of these offers, our disagreement would not affect the fact that the offer of FMC, after the addition of proper evaluation factors, would still be substantially lower than the offer of Cadillac prior to the addition of any evaluation factors. It is therefore apparent that the exclusion of rental on the Cleveland plant as a factor in evaluating Cadillac's offer would not have affected the evaluation of that offer to such an extent as to justify a determination by the Department of the Army that the M113 personnel carrier could be economically produced in the Cleveland plant.

While the record of testimony in this matter before your Subcommittee and the unusually high amount of the basic offer by Cadillac raise the question whether such offer represents a realistic estimate of the cost of production at the Cleveland plant, the fact remains that such offer represents the only assurance to the Department of the Army that any manufacturer was willing to produce the M113 in the Cleveland plant at any price.

Our review of this procurement included examination of the records and files of the Ordnance Tank-Automotive Command and analysis of the offers submitted to that activity. In comparing the elements of cost included in the various proposals, we found that Cadillac, notwithstanding the fact it proposed to use the Cleveland plant and would therefore have incurred no plant depreciation costs, included $9 million as manufacturing overhead, while FMC, which would incur depreciation on its privately-owned plant, included only $3.2 million for manufacturing overhead in its proposal. Similarly, the direct material costs included in Cadillac's proposal exceeded such cost in FMC's proposal by $8.7 million. The difference in the estimates on these two elements of cost appears to account for the difference between the unevaluated prices proposed by the two companies, and would also appear to support the testimony before your Subcommittee to the effect that Cadillac's offer was not truly competitive. It should be noted, however, that the question whether Cadillac, in the absence of a requirement in the request for proposals that Bulletin No. 60-2 be applied in evaluating its proposal, would have submitted a proposal in any different amount or, in the event it had done so, whether such amount would have been reduced sufficiently to compete with the offers by FMC and Todd Shipyards, is, on the record, purely speculative or conjectural. We have therefore made no effort to establish whether application of the Bulletin No. 60-2 evaluation factors to this procurement did, in fact, result in the submission of a noncompetitive offer by Cadillac.

Under the circumstances, it is our opinion that the question whether application of Bulletin No. 60-2 to this procurement did result in a determination to produce in private facilities when the items could have been economically produced in the Cleveland plant must be decided on the basis of the offers received. As indicated above, a comparison of such

offers does not support a conclusion that production in the Cleveland plant would have been economical.

While your request for a review of this procurement appears to be limited to application of the provisions of 10 U.S.C. 4532(a) and Bulletin No. 60-2, our investigation has indicated an additional factor in the evaluation of proposals which appears to require comment.

In evaluating the FMC proposal, the Department of the Army deducted the sum of $1,152,000 as "Related Cost Savings, Other Contracts." As indicated by the testimony on pages 188-194 of the transcript of the hearings, this is the amount by which FMC agreed to reduce its price for 900 vehicles currently in production under contract No. DA-04-200-ORD-956 if it was awarded the new contract for 1,380 vehicles under RFP No. 60-37. The hearings also indicate (page 192) that the sum of $1,152,000 was to be applied against special tooling to insure it represented a legitimate return to the Government of that amount, and (page 194) that this amount represented out-of-pocket money under contract ORD-956 that would not have been recovered except in the form of a rebate of this nature.

The records of this procurement disclose that personnel of the Ordnance Tank-Automotive Command (OTAC), in reviewing FMC's proposal and in negotiating with that company under RFP No. 60-37, insisted on a reduction in the element of profit and a lower escalation factor for use in price redetermination. The offer by FMC to reduce its price on contract ORD-956 appears to have been submitted as a counter-offer to OTAC's request for reductions in profit and escalation proposal under RFP No. 60-37. According to the minutes of these negotiations, it was OTAC's position that a reduction in the cost of special tooling under contract ORD-956 would not be an actual saving but merely a device by which a cost properly allocable to that contract would be postponed to a future contract, and that it should not be used as an evaluation factor since it did not appear to be favorable from the Government's standpoint. OTAC personnel inquired as to the reasons for the willingness of FMC to reduce its price on contract ORD-956 in lieu of reducing its price under RFP No. 60-37. They were advised by FMC representatives that one reason was the "tax situation"--which, however, was not amplified--and another reason was the firm conviction of management that the company was entitled to a 9.5 percent profit.

Prior to the deduction of the $1,152,000, FMC's offer was more than $500,000 higher than the offer submitted by Todd Shipyards Corporation. Application of the refund under contract ORD-956 as an evaluation factor therefore operated to make FMC, rather than Todd Shipyards, the low offeror.

While the records of OTAC's negotiations with FMC do not indicate that consideration was given to the question whether the offered reduction

in the price of contract No. ORD-956 would actually result in a saving of that or any other amount to the Government, as distinguished from a saving to the Department of the Army, we have been advised by Army officials that consideration was given to the question whether some or all of the $1,152,000 might be recoverable as income tax or excessive profits under the Renegotiation Act of 1951. However, we were also advised that because no deliveries or payments had been made under contract ORD-956 during 1959, and it was impossible for the Department of the Army to ascertain FMC's tax or renegotiation position for 1960, it was decided that the possibility of the Government recovering all or part of the $1,152,000 through such channels would not preclude using the full amount as a savings factor in evaluating FMC's proposal. Additionally, we were advised that the Office of the Judge Advocate General had found no legal objection to the use of such evaluation factor. In view thereof, it was decided that it would be in the best interest of the Government to use the resultant saving as an evaluation factor and to accept FMC's offer.

Whether any portion of the $1,152,000 represented profit recoverable by the Government as income tax or excess profits would appear to be unanswerable at this time. It is therefore our opinion that the testimony by Army personnel before your Subcommittee to the effect that the $1,152,000 to be refunded represented profits which could not be recovered by the Government in any other manner, cannot be supported by the present record. Additionally, it should be noted that the acceptance of a reduction in the existing contract price and the failure to effect a reduction in the proposed profit and upward escalation under RFP No. 60-37 would appear to place the company in a position to offer a similar refund on the contract awarded under RFP No. 60-37 to apply against its proposed price on any future Government contract on which the company may bid. This procedure appears to give a definite and completely unjustified competitive advantage to the holder of a Government contract without assurance of a corresponding benefit to the Government.

While the authority to make contracts by negotiation rather than by competitive bidding carries with it a broad discretionary authority to determine what award and what terms will best serve the interest of the Government, and the negotiating officials are not bound to make awards on the basis of price alone, it seems apparent that in this instance the final decision to award to FMC turned upon the acceptance of that company's offer of the price reduction under the prior contract. We do not find that the record in this case clearly justifies the conclusion that the award to FMC was in the best interest of the Government pricewise, and we seriously question the propriety, as a general practice, of considering the offer of such a possible collateral benefit to the Government as a controlling factor in the award of a contract where the final choice of the contractor becomes a matter of price alone.

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In a formally advertised procurement we believe that it would be improper to consider such an offer in a bid, since to do so would introduce an evaluating factor which would make it difficult, if not impossible, to evaluate all bids on a common and uniform basis. The possible effects of a price change under some prior contract upon tax liability, or price redeterminations, or renegotiation of profits, would, we believe, preclude evaluation of the reduction at its face value; at the same time we feel that any attempt to evaluate those effects, even if it were possible to do so, would introduce into the competitive bidding procedure extraneous factors which properly should have no place therein.

In a negotiated procurement the same considerations should apply, so far as price evaluation is involved, although perhaps less strongly. We do not mean to imply that such an offer should not be considered in negotiation; but we feel that its acceptance as a basis for award of a contract should be justified by a definite determination that such action was in the overall best interest of the Government and not merely on the basis of a prima facie or ostensible price differential.

As indicated above, the fact that the contract was negotiated and awarded under 10 U.S.C. 2304(a)(16) precludes this Office from questioning the legality of the award or the expenditure of public funds under the contract awarded. However, we have today called the attention of the Secretary of Defense and the Secretary of the Army to the fact that we consider this aspect of the evaluation procedure improper and have suggested that consideration be given to the issuance of such directives as may be necessary to specifically prohibit its future use.

The transcript of hearings and other enclosures received with your letter of July 8 are returned.

Sincerely yours,

JOSEPH CAMPBELL

Comptroller General
of the United States

Enclosures