GAO

Fact Sheet for the Honorable
Bob Packwood, United States Senate

October 1986

NAVY CONTRACTING

U.S. Navy Ship Repair Contracting at Canadian Shipyards

GAO/NSIAD-87-17FS

GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-220972

October 10, 1986

The Honorable Bob Packwood
United States Senate

Dear Senator Packwood:

In response to your letters of April 23 and May 15, 1985, and subsequent discussions with your office, we gathered information on U.S. Navy ship repair contracts awarded to Canadian shipyards. The enclosed fact sheet contains answers to the specific questions raised in your May 15, 1985, letter, which appears as appendix I.

We are providing further information regarding reciprocal competition to you in a separate, classified fact sheet (GAO/C-NSIAD-87-1FS).

The principal unclassified results of our work pertaining to your questions show that:

--The United States and Canada have had a special military contracting agreement since 1952.

--The Navy's authority to contract with Canadian sources has several restrictions, such as those associated with small business and labor surplus area set-aside legislation.

--Subject to these restrictions, the Military Sealift Command makes all ships for which it has repair responsibility available for potential contracting to qualified Canadian shipyards.

--Seven Military Sealift Command ships have been repaired in Canada since fiscal year 1980, at a total contract price of about $10 million.

--The Military Sealift Command's Canadian contracts were based either on the need to make emergency repairs or on price competition with U.S. shipyards.

--Canadian shipyards do not have to comply with a number of statutory and regulatory guidelines that U.S. bidders must comply with, but these shipyards might have to comply with some similar Canadian policies.

--There was no evidence in the contract files to indicate that the Canadian shipyards that have successfully bid for Navy contracts received any assistance from the Canadian government's Canadian Commercial Corporation in the bid preparation process.

--Of nine U.S. shipyards contacted on the West Coast, none has repaired ships or has participated in competitive bidding to repair ships belonging to the Canadian government for at least 6 years.

During our review, we (1) interviewed responsible agency officials in the Office of the Secretary of Defense, the Office of the Secretary of the Navy, the Military Sealift Command, and the Naval Sea Systems Command, (2) reviewed contract files and obtained statistical data at the Atlantic and Pacific Area Commands of the Military Sealift Command, (3) conducted a computer search of defense procurement data that identified Navy ship repair contracts with Canadian sources, (4) reviewed the Navy's authority to contract with Canadian sources and applicable contracting regulations, (5) interviewed key officials of nine U.S. shipyards on the West Coast, (6) interviewed officials in the Departments of State and Commerce, and (7) reviewed other applicable documentation--some from the Library of Congress and the National Archives and Records Administration. We responded to each question on the basis of information obtained from U.S. sources and did not contact the Canadian government.

We provided Department of Defense and Navy officials an opportunity to review a draft of the enclosed fact sheet for accuracy and completeness. Their comments have been included where appropriate.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this fact sheet until 30 days from its issue date. At that time, we will send copies to the Secretaries of Defense, the Navy, and State. We will also make copies available to others upon request.

Should you need further information concerning the fact sheet, please call me on 275-6504.

Sincerely yours,

John Landicho

John Landicho
Senior Associate Director

Contents

FIGURE

ABBREVIATIONS

ASPA	Armed Services Procurement Act
CCC	Canadian Commercial Corporation
DFARS	DOD FAR Supplement
DOD	Department of Defense
FAR	Federal Acquisition Regulation
GAO	General Accounting Office
I&L	Installations and Logistics
IPD	Interport differential
LSA	Labor surplus area
MSC	Military Sealift Command
MSRA	Master ship repair agreement
NAVSEA	Naval Sea Systems Command
R&D	Research and development
TIAS	Treaties and Other International Acts Series
USNS	U.S. naval ship

Section 1

U.S.-CANADA DEFENSE PROCUREMENT AND PRODUCTION COOPERATION

THE CONTRACTING AGREEMENT AND OVERALL DEFENSE PRODUCTION ARRANGEMENT

Question Do the United States and Canada have a special arrangement with regard to military contracting?

Answer Yes. A special military contracting agreement between the United States and Canada has existed since 1952. It establishes policies and procedures to facilitate U.S. military department procurements of supplies and services from Canadian sources. This agreement is part of an overall defense production arrangement that originated in World War II. The overall arrangement has continued to develop over the years as various agreements and policy statements have been issued and implemented. The production sharing arrangement began in 1959 as a result of (1) a 1958 decision by the Canadian government to increase its reliance on the United States for certain major weapons systems and (2) a reciprocal U.S. policy action to permit Canadian industry a fair opportunity to share in the production of military equipment. The arrangement recognizes Canadian industry as part of the U.S. mobilization base and affords it an equal competitive footing for the award of U.S. defense contracts, including those for ship repair services.

Facts

The current military contracting agreement, which revised a similar February 26, 1952, agreement, is evidenced by a Letter of Agreement with Canada, dated July 27, 1956. (See app. II.) The agreement was proposed by Canada's Deputy Minister of Defence Production and accepted by the appropriate Assistant Secretaries of the U.S. Army, Navy, and Air Force. It also was accepted on October 15, 1962, by the Director of the Defense Supply Agency (now known as the Defense Logistics Agency). The agreement is part of an overall defense production arrangement, which is further discussed in appendix III.

The agreement sets forth policies and procedures for all contracts placed on or after October 1, 1956, by any of the U.S. military departments with the Canadian government's Canadian Commercial Corporation (CCC). (The functions of the

CCC are briefly described in app. IV.) Under the agreement, the CCC agrees to subcontract with Canadian suppliers in accordance with Canada's defense procurement practices, policies, and procedures.

With respect to contracts awarded as a result of formal competitive bidding, the CCC will bid in U.S. currency, and no adjustment for losses or gains resulting from fluctuations in exchange rates will be made.

For contracts other than those awarded as a result of formal competitive bidding, the agreement provides that:

--Quotations, prices, cost data, invoices, and payments will be in Canadian currency, unless otherwise elected by the CCC; in which event, such contracts will not be subject to adjustment for losses or gains resulting from fluctuations in exchange rates.

--The CCC will cause audits and verifications of cost to be performed using Canadian guidelines and render its certificate to the military departments.

--The CCC will refund excess profits of first-tier subcontractors and any profits not considered fair and reasonable that are recovered from subcontractors of any tier.

--Before refunding profits, the CCC is entitled to deduct any losses it may sustain.

--The CCC will not allow profit rates to exceed any limit prescribed by U.S. statute.

In addition, the agreement generally provides that

--prices in fixed price and cost reimbursement type contracts will not include any taxes or custom duties refundable under Canadian law with respect to first-tier subcontracts;

--the CCC will use its best efforts to exclude taxes and duties from all subcontracts below the first tier;

--audits of costs and profits on contracts placed with the CCC will be made without charge;

--the CCC recognizes U.S. law prohibiting the use of cost-plus-a-percentage-of-cost contracting;

--covered contracts shall be deemed to include the provisions required by Public Law 245 (65 Stat. 700), which sets forth the audit authority of the Comptroller General, and section 719 of Public Law 458 (68 Stat. 353), which sets forth the government's right to terminate contracts if gratuities are found; and

--the parties can terminate the agreement by mutual consent or a 6-month written notice.

It also provides reciprocal arrangements facilitating procurement by each party in the country of the other to generally (1) avoid any surcharges covering administrative costs,[1] (2) provide free inspection services, and (3) avoid any charges for the use of government-furnished facilities.

RECIPROCAL COMPETITION UNDER THE DEFENSE PRODUCTION SHARING PROGRAM

Question — Can U.S. shipyards bid for Canadian government ship overhaul and maintenance work?

Answer — (CLASSIFIED) (See GAO/C-NSIAD-87-1FS.)

Facts — (CLASSIFIED) (See GAO/C-NSIAD-87-1FS.)

Question — Have U.S. shipyards participated in competitive bidding for Canadian government ship repair work in the recent past?

Answer — No. Of nine U.S. shipyards we contacted on the West Coast, none has repaired or participated in competitive bidding to repair ships belonging to the Canadian government for at least 6 years.

Facts

We contacted nine U.S. shipyards on the West Coast to determine whether they had participated in competitive bidding for Canadian government ship repair work in the recent past. These nine shipyards were the only U.S. shipyards to unsuccessfully bid against a Canadian shipyard for the repair of U.S. naval ships. The shipyards contacted were

--Lockheed Shipbuilding Co., Seattle, Washington;

--Todd Pacific Shipyards Corp., Seattle, Washington;

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[1]On June 1, 1986, the CCC began a fee-for-service system, which is discussed in section 5 under Canadian Government Assistance.

--Dillingham Ship Repair, Portland, Oregon;

--Lockport Marine Co., Portland, Oregon;

--Northwest Marine Iron Works, Portland, Oregon;

--Continental Maritime of San Francisco, Inc., San Francisco, California;

--Southwest Marine, Inc., San Diego, California;

--Todd Shipyards Corp., San Francisco, California; and

--Triple "A" Machine Shop, Inc., San Francisco, California.

Officials from all of these shipyards stated that the shipyards had not, since October 1, 1979,

--repaired any ship of the Canadian government,

--submitted an unsuccessful offer to repair any ship of the Canadian government, and

--declined to submit an offer in response to a solicitation to repair any ship of the Canadian government.

Only one of the shipyards (Northwest Marine Iron Works, Portland, Oregon) had informally contacted officials of the Canadian government to inquire about Canadian government ship repair opportunities.

Section 2

NAVY AUTHORITY TO CONTRACT

Question Are there any restrictions existing on foreign (Canadian) procurement when competitive domestic contractors are available?

Answer The Armed Services Procurement Act does not limit competition for defense contracts to domestic sources. However, the Navy's authority to contract with foreign (Canadian) sources for ship construction and repair services is subject to several restrictions. These restrictions include a provision in recent appropriations acts prohibiting the expenditure of shipbuilding and conversion funds in foreign shipyards for the construction of naval vessels, or major components of their hulls or superstructures, as well as small business and labor surplus area set-aside programs. The Navy's authority to contract with Canadian sources is not restricted by the Buy American Act.

Facts

The statute of general application governing defense procurement, and which provides congressional defense procurement policy, is the Armed Services Procurement Act (ASPA) of 1947, as amended (Feb. 19, 1948, 62 Stat. 21). The ASPA is applicable to the Department of the Navy and is codified in chapter 137 of title 10 of the United States Code (10 U.S.C. 2301 et seq.).

The ASPA, as amended by the Competition in Contracting Act of 1984 (Public Law 98-369), requires the Navy to obtain full and open competition in the award of its contracts by soliciting sealed bids or using other competitive procedures, unless a statutory exception is met. The ASPA, however, does not expressly limit competition for defense and Navy contracts to domestic sources.

In this connection, Comptroller General bid protest decisions have dismissed protests by disappointed bidders who argued that contract awards were invalid because the awardees were foreign-owned companies. In one case, the protester maintained that since domestic operators could perform needed aviation services, award of a contract to a foreign firm was not in the government's or the taxpayers' best interests. The Comptroller General dismissed the protest stating that:

"...we are not aware of any federal law that would authorize the Navy to exclude, or would prevent, a foreign firm from competing for the subject contract. Thus, there would be no legal basis for objecting to the award to a qualified, responsible foreign offeror that submitted the best proposal." (Evergreen Helicopters, Inc., B-215373, July 18, 1984, 84-2 CPD ¶ 62.)

In another case, the protester argued that foreign firms are not subject to the same inspection, equal employment, environmental, and other requirements imposed on domestic firms by U.S. law and that domestic bidders consequently incur greater costs, resulting in unequal competition and destroying the integrity of the procurement process. In rejecting this position, the Comptroller General relied on a prior decision that held that a foreign bidder's possession of economic advantages, such as those relating to taxes and minimum wage standards, provides no basis for rejecting the foreign bid. (Fire & Technical Equipment Corp., B-203858, Sept. 29, 1981, 81-2 CPD ¶ 266; Milmark Services, Inc., B-175833, Sept. 25, 1972.)

The ASPA is implemented by the Federal Acquisition Regulation (FAR), which provides uniform policies and procedures for acquisitions by all executive branch agencies, including the Department of Defense (DOD). The ASPA is further implemented by the DOD FAR Supplement (DFARS), which, in part, expressly implements the military contracting agreement between the two countries by establishing a mechanism whereby Canadian firms may bid on U.S. contracts. Also, the FAR and DFARS are further supplemented by military department regulations, such as the Navy Acquisition Regulations Supplement, and by regulations of individual commands, such as the Military Sealift Command's (MSC's) contract procedures for use in procurement of ship maintenance, repair, and alterations.

While foreign firms may compete for federal contracts, no such awards may be made unless the contracting officer first determines, as provided in FAR 9.103 and 9.105-2, that the prospective contractor is responsible. Before making this determination, the contracting officer is required, as stated in FAR 9.104 and FAR 9.105-1, to possess sufficient information that the prospective contractor is qualified and eligible to receive an award under applicable laws and regulations and, for example, has (1) adequate financial resources, (2) a satisfactory record of performance, integrity, and business ethics, and (3) an ability to comply with the delivery or performance schedule.

No government contract can be entered into unless a contracting officer ensures that all requirements of law, executive orders, regulations, and other applicable procedures

have been met. With respect to ship construction and repair services, the Navy's authority to contract with foreign (Canadian) sources is subject to several legislative and other restrictions.

The Burns-Tollefson Amendment

This amendment has been incorporated into the Department of Defense Appropriations Act in recent years and is located under "Shipbuilding and Conversion, Navy." The amendment in the 1986 act (Public Law 99-190, 99 Stat. 1196) reads:

> "Provided further, That none of the funds herein provided for the construction or conversion of any naval vessel to be constructed in shipyards in the United States shall be expended in foreign shipyards for the construction of major components of the hull or superstructure of such vessel: Provided further, That none of the funds herein provided shall be used for the construction of any naval vessel in foreign shipyards."

Small Business Legislation

According to the ASPA (10 U.S.C. 2301(c)), it is congressional policy that a fair proportion of the defense purchases and contracts be placed with small business concerns. The Small Business Act of 1953, as amended (15 U.S.C. 631 et seq.), states a similar overall government policy.

To help implement this policy, FAR 19.501 generally provides that the contracting officer should review acquisitions to determine if they can be set aside for award exclusively to small business concerns. According to FAR 19.502-2, the entire amount of an individual acquisition is to be set aside if the contracting officer determines that there is a reasonable expectation that (1) offers will be obtained from at least two responsible small business concerns and (2) award will be made at a reasonable price.

Under FAR 19.502-3, a partial set-aside is to be made when a total set-aside is not appropriate and, among other circumstances, when (1) the requirement is severable into two or more economic production runs or reasonable lots and (2) one or more small business concerns are expected to have the technical competence and productive capacity to satisfy the set-aside portion of the requirement at a reasonable price. (With respect to ship repair work, an acquisition may be severable, for example--when operational requirements permit--if it includes drydocking and topside work.)

A concern that is bidding on a set-aside contract must meet the applicable industry size standard the Small Business Administration has established. For the shipbuilding and repair industry, the maximum size standard is 1,000 employees, as stated in FAR 19.102. When set-aside determinations have been made, offers received from concerns that do not qualify as small business concerns should be considered nonresponsive by the contracting officer and rejected, as stated in FAR 19.502-4. FAR 19.101 defines "concern" as:

> "...any business entity located inside the United States that is organized for profit (even if it is owned by a nonprofit entity), pays U.S. taxes, and/or uses American products, material, and/or labor, etc." (Underscoring supplied.)

Generally, whether a particular procurement should be set aside for small business concerns is up to the discretion of the contracting agency. (Detroit Broach and Machine--Reconsideration, B-213643.2, July 12, 1984, 84-2 CPD ¶ 43 and Par-Metal Products, Inc., B-190016, Sept. 26, 1977, 77-2 CPD ¶ 227.)[1]

Labor Surplus Area Legislation

Section 644 of the Small Business Act establishes an overall government policy that priority shall be given to the award of contracts to concerns located in labor surplus areas (LSAs). In addition, the Department of Defense Appropriations Act, 1986 (Public Law 99-190, section 8076) states:

> "It is the sense of the Congress that the Secretary of Defense should formulate and carry out a program under which contracts awarded by the Department of Defense in fiscal year 1986 would, to the maximum extent practicable and consistent with existing law, be awarded to contractors who agree to carry out such contracts in labor surplus areas (as defined and identified by the Department of Labor)."

Policies and procedures for aiding LSAs in the United States, U.S. territories and possessions, the Commonwealth of Puerto Rico, and the Trust Territory of the Pacific Islands are set forth in part 20 of the FAR and the DFARS. FAR 20.101 defines an LSA as a geographical area identified by the Department of Labor as an area of concentrated unemployment or under employment or an area of labor surplus. The Department of Labor generally classifies various areas as LSAs whenever the

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[1]FAR 19.501(g) describes a circumstance where an award must be set aside for small businesses.

areas' average unemployment rates exceed certain established levels, e.g., 10 percent or more during the previous 2 calendar years (20 CFR part 654). Defense Manpower Policy 4B (May 23, 1980, 44 CFR part 331) states the government's policy to encourage the placing of contracts and facilities in LSAs and to assist such areas in making the best use of their available resources.

Pertaining to LSAs, the Maybank Amendment (10 U.S.C. 2392(b)) provides that no DOD funds can be used to pay a price differential for the purpose of relieving economic dislocations. In other words, such contracts must be awarded at prices no higher than those obtainable from other concerns. Before being codified in title 10, the provision first appeared in the 1954 Defense Appropriation Act (Public Law 179, 67 Stat. 336).

In 1961, the Comptroller General determined, based on an analysis of the Maybank Amendment and its legislative history, that total set-asides for LSA firms based on obtaining only a fair and reasonable price violated the Maybank Amendment's prohibition of paying contract price differentials for the purpose of relieving economic dislocations (40 Comp. Gen. 489). As a result, DOD does not use total set-asides for LSA firms. DFARS 20.7001-3 only provide for partial set-asides for LSA concerns, to the extent consistent with procurement objectives, if (1) an acquisition is severable into two or more economic production runs or reasonable lots and (2) one or more LSA concerns are expected to qualify as LSA concerns and to have the capability to furnish a severable portion of the acquisition at a reasonable price. However, such contracts can be awarded at prices no higher than those obtainable from other concerns.

According to a Comptroller General decision (Wexler Paper Products, B-170285, Nov. 10, 1970), whether a portion of a particular procurement should be set aside for LSA concerns is up to the discretion of the contracting officer.

To implement this policy and to accommodate the small business policy previously discussed, DFARS 20.7001 requires that preference shall be given in the following order of priority to (1) LSA concerns that are also small business concerns, (2) other LSA concerns, and (3) small business concerns that are not LSA concerns.

Depressed Industry Designation

As stated in Defense Manpower Policy 4B, when an entire industry that sells a significant proportion of its production to the government is generally depressed or has a significant proportion of its production, manufacturing, and service facilities located in an LSA, the Director, Federal Emergency Management Agency, or successor in function, after notice to and hearing of interested parties, will consider appropriate measures applicable to the entire industry. Designations of

depressed industries are made by Federal Emergency Management Agency notifications, and contracting officers are to give industries special treatment as specified in the notifications.

Buy American Act

The Navy's authority to contract with Canadian sources is not restricted by the Buy American Act. The act (41 U.S.C. 10a-d) generally requires that only domestic articles, material, and supplies be acquired for public use in the United States, unless an agency head determines their purchase to be inconsistent with the public interest or their cost to be unreasonable. Implementing provisions in FAR 25.100 state that the act applies to supply contracts and contracts for services that involve the furnishing of supplies.

As implemented and interpreted by Executive Order 10582, December 17, 1954, as amended, the act only establishes a preference for domestic supplies, not the total exclusion of those of foreign origin. The preference is accomplished through the use of evaluation factors or differentials that are added to bids or offered prices of foreign supplies.

The Deputy Secretary of Defense, however, determined on May 9, 1980, that it was inconsistent with the public interest to apply the Buy American Act to the acquisition of Canadian produced or manufactured defense equipment. Thus, bids and proposals from Canadian sources are treated on an equal basis with domestic firms in competition for government contracts.

Section 3

U.S. SHIPS AVAILABLE FOR CANADIAN REPAIR

BASIS FOR AVAILABILITY

Question — Are all classes of ships available for foreign (Canadian) shipyard repair?

Answer — The Military Sealift Command makes all ships for which it is responsible for repair available for potential contracting to qualified Canadian shipyards. The Naval Sea Systems Command (NAVSEA) has not yet made any of its ships available to Canadian shipyards.

Facts

The Director of MSC's Services Contracting Division stated that all MSC owned or controlled ships for which MSC is responsible for repair are available for foreign (Canadian) repair, unless a ship's mission precludes it. The MSC fleet, according to MSC's July 15, 1985, Force Inventory, consisted of 124 ships (59 Navy owned and 65 privately owned, which were chartered by MSC). Most of the ships in MSC's fleet were operated by contractors that were also responsible for repairing the ships. MSC was responsible for the repair of 50 ships (48 Navy owned and 2 privately owned), according to the Deputy Director of MSC's Engineering Operations Division. (These 50 ships are identified in app. V.)

MSC officials stated that MSC keeps track of its ships by "type" or "classification," not by "class." (The type or classification assigned to each ship for which MSC was responsible for repair on July 15, 1985, is also shown in app. V. Classifications of naval ships and craft are promulgated by Secretary of the Navy Instruction 5030.1J.)

The Director of NAVSEA's Contract Administration, Surface Ship Overhaul Acquisition, and Claims Settlement Division stated that NAVSEA solicits bids for ship repairs only from shipyards that have master ship repair agreements (MSRAs)[1] with NAVSEA and that currently no Canadian shipyards have MSRAs with

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[1]An MSRA, which is officially titled Master Agreement for Repair and Alteration of Vessels, is not a contract and contains no statement of work. It establishes, in advance, the terms and conditions under which work will be performed in the event a job order or contract is awarded. MSRAs are entered into with all prospective contractors that request ship repair work and possess the organization and facilities to perform the work satisfactorily.

NAVSEA. He also stated that NAVSEA will not consider a shipyard for a contract to repair a NAVSEA ship if the yard only has an MSRA with MSC. Therefore, according to the Director, NAVSEA's practice has been to only solicit bids from and to contract with U.S. shipyards that have MSRAs with NAVSEA.

The status of MSRAs between the Navy and Canadian shipyards as of March 10, 1986, is further discussed in appendix VI.

SHIPS REPAIRED IN CANADA

Question — How many Navy and MSC ships have been repaired in Canada in recent years?

Answer — Seven ships under the responsibility of MSC and no other Navy ships have been repaired in Canada since fiscal year 1980.

Facts

According to MSC officials, seven MSC ships have been repaired in Canada since fiscal year 1980. Eight contracts were awarded because one ship was repaired twice.

The total dollar amount of these contracts, which were awarded by MSC's Atlantic and Pacific Area Commands between September 29, 1980, and December 6, 1985, was $10,178,682. A list of the contracts is provided in table 3.1.

Table 3.1: List of MSC Ship Repair Contracts Awarded to Canadian Shipyards

Award date	Ship name/type[a]	Contract amount	Canadian shipyard
		(U.S. dollars)	
Sept. 29, 1980[b]	USNS Waccamaw (T-AO 109)	$ 1,567,162	Davie Shipbuilding Ltd., Levis, Quebec
July 17, 1982[b]	USNS Northern Light (T-AK 284)	4,069	Halifax Industries Ltd., Halifax Shipyard, Halifax, Nova Scotia
Nov. 8, 1984[c]	USNS Neptune (T-ARC 2)	1,308,561	Burrard Yarrows Corp., N. Vancouver, B.C.
Apr. 5, 1985[c]	USNS Spica (T-AFS 9)	3,495,506	Burrard Yarrows Corp.
July 2, 1985[b]	USNS Wyman (T-AGS 34)	124,000	Halifax Industries Ltd.
July 18, 1985[b]	USNS Wyman (T-AGS 34)	153,300	Halifax Industries Ltd.
Aug. 2, 1985[c]	USNS Kawishiwi (T-AO 146)	2,740,869	Versatile Pacific Shipyards Inc., N. Vancouver, B.C. (formerly Burrard Yarrows Corp.)
Dec. 6, 1985[c]	USNS Zeus (T-ARC 7)	785,215	Versatile Pacific Shipyards Inc.
Total		$10,178,682	

[a]MSC ships have the prefix "USNS" for U.S. naval ship.

[b]Award made by MSC, Atlantic.

[c]Award made by MSC, Pacific.

Of the eight contracts, five were awarded in fiscal year 1985, with a total dollar amount of $7,822,236. During the same period, these two Area Commands awarded 74 ship repair contracts that had a total dollar amount of $44,767,531 to U.S. firms. The Canadian shipyards, therefore, received 6.3 percent of the Area Commands' total number of awards and 14.9 percent of the contracts' total dollar amount. (Apps. VII and VIII show the combined and individual Area Command ship repair procurements, by fiscal year, since 1980.)

The Director of NAVSEA's Contract Administration, Surface Ship Overhaul Acquisition, and Claims Settlement Division stated that he does not believe NAVSEA has ever contracted with the CCC for ship repairs. He believes the only exception is the remote possibility of emergency voyage repairs, but he does not recall such repairs being performed in any Canadian shipyard.

Our computer search of data made available by the Directorate for Information, Operations, and Reports in the Office of the Secretary of Defense did not disclose any NAVSEA or additional MSC ship repair contracts with Canadian shipyards. The data covered DOD's contract actions over $25,000 from fiscal years 1980 through 1985.

Section 4

IMPLEMENTATION OF THE CONTRACTING AGREEMENT

DECIDING THE USE OF A CANADIAN SHIPYARD

Question How do MSC and the Navy determine which ships will be repaired in Canada?

Answer Available procurement documentation shows that MSC's decisions to repair specific ships in Canada were based either on the need to make emergency repairs or on price competition with U.S. shipyards.

Facts

MSC's Atlantic Area Command awarded four contracts to Canadian firms because of the need to make emergency repairs. The first contract was awarded on September 29, 1980, to repair the USNS Waccamaw. The contract file on this award could not be located by MSC, Atlantic. A contract log book, however, shows the work consisted of an emergency structural repair that was performed by Davie Shipbuilding Limited (Levis, Quebec), from October 14, 1980, to November 28, 1980.

The second contract, which was awarded on July 17, 1982, was to repair the USNS Northern Light. A Sole Source Procurement Board document in the contract file stated:

> "...the ship is incapable of performing operational tasks until boiler repairs have been accomplished. Halifax Industries Ltd. is the only yard in the area with a master ship repair contract and capacity to perform the work in the designated time period."

Halifax Industries was the only source solicited and it was awarded a negotiated job order to make emergency voyage repairs.

The third contract, which was awarded on July 2, 1985, was to make repairs to the USNS Wyman. An internal MSC, Atlantic, memorandum in the contract file indicates that an emergency began when a seal failed, which permitted sea water to contaminate the oil in the lubrication system of the main propulsion stern tube bearing. The ship was directed to the nearest available port (Halifax, Nova Scotia) having a shipyard with a drydock. Further investigation there by a diver and a technical representative of the stern tube bearing and lubrication systems' manufacturer revealed that continued operation of the ship could possibly leave the ship without a means of propulsion. Because of a desire to minimize the further diversion of the ship from its priority mission, the

risk to the ship and personnel aboard, and the possibility of substantial towing charges, alternative repair sites in Canada and the United States were ruled out. The memorandum stated:

> "As required...unusual and compelling urgency is certified to the effect that immediate repairs were essential to facilitate mission redeployment and ship safety and that no other course would have satisfied all the needs of the government in this required repair action."

Halifax Industries Limited was authorized by message to proceed, under an issued job order, to make the needed drydocking repairs, which were completed by July 12, 1985.

The fourth contract, awarded on July 18, 1985, was also to repair the USNS Wyman. Documentation shows that on July 16, 1985, while attempting to complete its mission, the ship reported the need for additional repairs. The port main engine generator air circulation fan had lost about 25 percent of its blades, resulting in a vibration condition, and the ship was operating only on the starboard main engine. That unit, however, also was vibrating and there was concern that it might fail. Because the circumstances of this emergency were the same as the previous emergency for this ship, MSC certified:

> "...that no other course will satisfy all the needs of the government in this required repair action except to obtain these repairs as a Sole Source negotiated procurement from Halifax Industries Ltd. Halifax N.S., Canada."

Halifax Industries Limited was authorized by message to proceed, under an issued job order, to make the needed topside voyage repairs.

MSC's Pacific Area Command awarded four contracts to one Canadian shipyard based on price competition through the solicitation of sealed offers. The Canadian contractor's total evaluated bid price, as determined by MSC, Pacific, on these contracts was about $7,388,000. The MSC-determined total evaluated bid price of the lowest, responsive U.S. shipyards on these contracts was about $8,691,000, or 18 percent higher than the Canadian contractor's. A comparison of the evaluated bid price of the Canadian contractor and the lowest, responsive U.S. shipyard on each of the four contracts is shown in table 4.1. (App. IX presents a more detailed summary of the MSC, Pacific, bid evaluations and determination of the successful bidder.)

Table 4.1: Comparison of Evaluated Bid Prices on Four MSC Competitive Ship Repair Contracts

Ship	Evaluated Bid Price: Canadian firm	Evaluated Bid Price: U.S. firm	Difference: Amount	Difference: Percent
	(U.S. dollars)			
USNS Neptune	$ 734,563	$ 889,126	$ 154,563	21.0
USNS Spica	3,173,339	4,244,817	1,071,478	33.8
USNS Kawishiwi	2,694,996	2,728,086	33,090	1.2
USNS Zeus	785,215	828,791	43,576	5.5
Total	$7,388,113	$8,690,820	$1,302,707	17.6

MSC, Pacific, determined the solicitation area for these four awards to be the entire West Coast. This is known as "coastwise soliciting" and is one of two primary types of solicitation areas established by MSC Headquarters Instruction 4330.21C. The other primary type is "nationwide soliciting," which covers all coasts, and is used if repairs will take 12 months or longer. Its use requires MSC Headquarters approval.

When coastwise soliciting is used by MSC, Atlantic, both Atlantic and Gulf Coast ship repairers may bid. When coastwise soliciting is used by MSC, Pacific, all West Coast ship repairers may bid. Coastwise soliciting, however, is not generally used when it is impracticable and uneconomical, such as for voyage and emergency repairs or annual overhauls not exceeding 20 days.

The primary factor MSC considers when determining the solicitation area is the mission or schedule of the ship, which determines the period of time that it will be available for repair.

MSC Headquarters Instruction 4330.21C also provides that failure of a firm to have an MSRA will not preclude consideration of the firm's bid or offer; however, the firm must submit an MSRA application and be approved before the job order or contract may be awarded. Conversely, the award of an MSRA does not indicate the competence of a firm to perform a specific job order or contract because the contracting officer must always determine the responsibility of a prospective contractor before the award of a job order or contract.

One factor influencing the MSC Atlantic Area Command's lack of competitive awards to Canadian shipyards is its high incidence of small business set-asides for which Canadian firms are not eligible to bid. For example, for each fiscal year since 1982, about 90 percent or more of its contracts have been small business set-asides. (A comparison of small business set-aside data provided by MSC's Atlantic and Pacific Area Commands is shown in app. X.)

BIDDING PROCEDURES

Question — Does the shipyard itself submit bids, or does the Canadian government, or an entity of the government, submit the bids on the yard's behalf?

Answer — Defense acquisition guidance provides that offers by Canadian companies can either be processed through the CCC or be submitted directly, depending on the circumstances surrounding the procurement. No evidence existed in any of the contract file documentation we examined to indicate that the CCC had submitted an offer on behalf of a Canadian shipyard.

Facts

Guidance for making Canadian purchases is set forth in subpart 25.71 of the DFARS. Concerning the submission of offers, DFARS 25.7104(a)(2) states that:

> "(i) As indicated in 25.7104(b) below, the Canadian Commercial Corporation should normally be the prime contractor. In order to indicate its acceptance of offers by individual Canadian companies, the Canadian Commercial Corporation issues a letter supporting the Canadian offer and containing the following information: name of the Canadian offeror; confirmation and endorsement of the offer in the name of the Canadian Commercial Corporation; and a statement that the Corporation shall subcontract 100% with the offeror.
>
> "(ii) When a Canadian offer cannot be processed through the Canadian Commercial Corporation in time to meet the bid-opening requirement or the closing date for receipt of proposals, the Corporation is authorized to permit Canadian firms to submit offers directly; Provided, That the Canadian offer and the Canadian Commercial Corporation endorsement are both received by the contracting officer prior to bid opening or the closing date for receipt of proposals."

Regarding contracting procedures, DFARS 25.7104(b) states that:

> "(1) Individual contracts covering purchases from suppliers located in Canada, except as noted in (2) below, shall be made with the Canadian Commercial Corporation...
>
> "(2) The general policy in (1) above need not be followed for negotiated purchases for experimental, developmental, or research work unless the contract is for a project under the Defense Development Sharing Program; purchases of unusual or compelling urgency; small purchases; or purchases made by U.S. Defense activities located in the Dominion of Canada."

The three MSC, Atlantic, contracts for emergency repairs to the USNS Northern Light and the USNS Wyman were awarded to Halifax Industries Limited as the prime contractor, not the CCC. Contract files on these awards did not include any documentation that showed that the CCC either submitted an offer or participated in any price negotiations on behalf of the shipyard. Further, the contract files did not include any documentation that showed that the shipyard had submitted offers or negotiated prices for the work before the initial job orders were issued.

The four MSC, Pacific, contracts for repairs to the USNS Neptune, USNS Spica, USNS Kawishiwi, and USNS Zeus were awarded to the CCC as the prime contractor. However, the contract file documentation we examined did not indicate that the CCC had submitted any of the offers on behalf of its subcontractor, Versatile Pacific Shipyards (formerly Burrard Yarrows Corporation).

All of the bids were received with shipyard-prepared transmittal letters addressed to MSC, Pacific. According to an MSC, Pacific, official, the bids were submitted directly by the shipyard. Also, because the transmittal letters were dated only 1 to 3 days before bid opening, apparently they were not processed through the CCC. Individual messages from the CCC endorsing each bid, however, were received by MSC, Pacific.

An undated Production Sharing Guidebook prepared by the Canadian Department of External Affairs instructs Canadian manufacturers to submit bids under formally advertised competitive procurements to the office designated in the invitation for bid. Other evidence that the shipyard had submitted its bids directly is that the contract file on the USNS Kawishiwi includes a letter from Versatile, stating that one of its employees would deliver Versatile's bid and would attend the bid opening the next day.

Question — When a Canadian yard bids for U.S. government military work, does it do so in terms of U.S. dollars or Canadian dollars?

Answer — Defense acquisition guidance provides that when the CCC is involved (a) all competitive bids, offers, and quotations shall be submitted in U.S. currency and (b) all noncompetitive offers and quotations shall be submitted in Canadian currency, unless the CCC otherwise elects. Of the four competitive bids we examined, one was stated in U.S. dollars and three did not specify the type of currency bid. In addition, the type of currency used in three noncompetitive situations could not be determined because, as was previously stated, no offers or quotations had been received before the initial job orders were issued.

Facts

Defense acquisition guidance concerning the submission of offers states at DFARS 25.7104(a)(2) that:

> "(iii) All sealed bids shall be submitted by the Canadian Commercial Corporation in terms of U.S. currency...
>
> "(iv) All offers and quotations submitted by the Canadian Commercial Corporation, except those in which competition is obtained, shall be in terms of Canadian currency. However, the Corporation may, at the time of submitting the offer, elect to quote and receive payment in terms of U.S. currency;..."

Canada's Production Sharing Guidebook also states that bids, competitive proposals and quotations are to be made in U.S. currency.

Of the four competitive Canadian bids we examined:

--The bid on the USNS Neptune was stated in U.S. dollars.

--The bids on the USNS Spica, USNS Kawishiwi, and USNS Zeus did not specify the type of currency bid. MSC, Pacific, however, treated the bids as representing U.S. dollars.

Question — Are contract bids subject to adjustment as a result of differences in the exchange rate?

Answer — Under DOD guidance for implementing the contracting agreement, competitive bids, offers, and quotations would not be adjusted to account for differences in exchange rates because they would already be stated in U.S. dollars. Nor would it be necessary to adjust a noncompetitive offer or quotation submitted in Canadian dollars because such a procurement, as shown by past experience, would occur in sole-source emergency situations in which other U.S. offers are not also being evaluated. As was previously shown, none of MSC's contracts to date have involved shipyard offers that were specifically stated in Canadian dollars.

Section 5

POTENTIAL COMPETITIVE ADVANTAGES

FOR CANADIAN SHIPYARDS

CONTRACT CLAUSE EXEMPTIONS

Question — When Canadian companies bid for Navy ship repair work, are they subject to the same statutory and regulatory guidelines with which U.S. bidders must comply?

Answer — No. As of August 1, 1985, the DOD Federal Acquisition Regulation Supplement identified 87 contract clauses related to statutory and regulatory requirements that might be included in a NAVSEA or MSC MSRA. MSC reviewed the clauses and determined that 23 should not normally be included in an MSRA between the CCC and MSC for work to be performed solely in Canada. According to a Canadian shipyard, however, the objectives of some of these clauses are covered in Canada by similar legislation.

Facts

As of August 1, 1985, DFARS identified 87 contract clauses applicable to NAVSEA and MSC MSRAs and job orders. The first 33 clauses were stated to be mandatory by statute, executive order, or the FAR. The remaining clauses were to be included, as applicable.

MSC reviewed the clauses applicable to MSRAs and determined that 23 clauses should not normally be included in an MSRA between the CCC and MSC for ship repair work to be performed solely in Canada. Examples of such clauses follow.

--Contract Work Hours and Safety Standards Act-Overtime Compensation. (Clause does not apply to contracts performed in a foreign country.)

--Equal Opportunity Clause. (Contract exempt from Executive Order 11246 if work performed outside the United States by employees not recruited within the United States.)

--Affirmative Action for Disabled Veterans and Veterans of the Vietnam Era. (Clause does not apply to employment openings filled outside the United States.)

--Clean Air and Water. (Clause does not apply to work performed outside the United States.)

--Department of Labor Safety and Health Regulations for Ship Repairing. (Clause applies only to work performed on the navigable waters of the United States.)

(App. XI lists all of the clauses identified by MSC.)

According to a Canadian shipyard's bid, the objectives of some of these clauses are covered in Canada by similar legislation. The December 3, 1985, bid by Versatile Pacific Shipyards to repair the USNS Zeus states:

> "We would advise that the certification requested on the bid form...regarding Equal Opportunity and Clean Air and Water is covered in Canada by relevant Canadian Legislation. With regard to Affirmative Action, there is no equivalent Canadian law, however, we do adhere to the principles to the extent it is administered in Canada."

Canada's Production Sharing Guidebook states that many clauses in the standard bid documents do not apply to Canadian companies. It does not, however, identify the clauses.

CANADIAN GOVERNMENT ASSISTANCE

Questions

Do Canadian companies that bid for Navy contracts receive any assistance from the Canadian government in the bid preparation process? If so, does the shipyard reimburse the Canadian government for the value of this assistance?

Does the shipyard benefit in any other way from Canadian government assistance?

Answers

As stated earlier, there was no evidence in any of the contract file documentation we examined to indicate that the CCC had submitted any offer or provided any price negotiation assistance on behalf of a Canadian shipyard. If the CCC had provided bid preparation assistance on the contracts we examined, guidance concerning reimbursement for this service through user charges was contained in the military contracting agreement of 1956. The agreement includes a reciprocal arrangement to generally avoid any surcharges covering administrative costs. Beginning June 1, 1986, however, the CCC began to phase in a fee-for-service system which will result in a levy on payments made by the CCC to its Canadian suppliers.

A CCC annual report identifies other services that might benefit a Canadian shipyard. Examples of this assistance, most of which concern contract administration, relate to matters involving export permits, inspection, shipment, acceptance, and payment. We did not attempt to identify other benefits that might be provided by the Canadian government beyond those shown in the annual report.

Facts

Canada's Production Sharing Guidebook states the CCC's solicitation activity includes assisting companies to prepare the bid, proposal, or quotation.

Recent annual reports by the CCC state that its administrative and other expenses are normally covered by parliamentary appropriations. They also state that, with respect to traditional business, user charges have not been made for many years and are constrained by reciprocal and other agreements.

The military contracting agreement of 1956 includes a reciprocal arrangement to generally avoid any surcharges covering administrative costs.

By letter dated March 13, 1986, the President and Chief Executive Officer of the CCC confirmed for the Deputy Assistant Secretary of Defense for Procurement that the:

> "...Canadian Commercial Corporation will be introducing a fee for service system beginning June 1, 1986. The fee system will consist of a levy on payments made by the Corporation to its Canadian suppliers in government-to-government export transactions.
>
> "The fee system will be put into effect on a phased basis in order to minimize disruption of existing bilateral trade arrangements and supply patterns, and to provide our suppliers with time to adjust. A discount of 60% will be granted on billings subject to fee for service in 1986-87, thereby reducing the effective fee rate to 1% in the first year. A 30% discount will be applied in 1987-88 for a rate of 1.75% in that year. From 1988-89 and thereafter, full fee for service charges of a maximum of 2.5% will be applied to eligible transactions.

"...this fee system is designed to permit the Corporation to achieve self-sufficiency by 1990, in keeping with the Government of Canada's objective to reduce its expenditures and its annual budgetary deficit."

DOD's June 6, 1986, response to this letter indicated that DOD wanted to renegotiate the 1956 U.S. Letter of Agreement with Canada so that it better reflects future procedures and reciprocal responsibilities. The response also mentioned procedures under which contracts could be placed with Canadian industry, as well as through the CCC, and reciprocal responsibilities for contract management, quality assurance, and audit services. In the interim, DOD asked the CCC to confirm its intention of excluding from the fee for service costs that are attributable to quality assurance and audit services integral to the 1956 agreement, and reserved the right to negotiate the reasonableness of the fee.

The CCC Annual Report 1979-80 states that CCC services to Canadian suppliers include

--providing access to overseas government purchasing offices, including the establishment of purchase agreements between the Corporation and customer governments and international agencies;

--assisting Canadian companies to export while remaining in a domestic environment;

--administering contracts;

--helping to obtain export permits;

--arranging inspection, acceptance, and shipment as required; and

--making prompt payment to Canadian business firms.

APPENDIX I

REQUEST LETTER

United States Senate

COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION

WASHINGTON, DC 20510

May 15, 1985

The Honorable Charles A. Bowsher
Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20549

Dear Mr. Bowsher:

On April 23, 1985, I wrote you concerning Navy ship repair contracts being awarded to competing Canadian shipyards. I am still deeply interested in this issue, both as to the technical aspects of my constituents' protest which is presently under consideration in your General Counsel's Office, as well as the broader policy implications which could be explored in an audit.

With regard to the broader policy review, there are a number of questions which I hope would be addressed in your audit:

1. How does the Military Sealift Command (MSC) and and the Navy determine which ships will be repaired in Canada? Are all classes of ships available for foreign shipyard repair?

2. How many Navy and MSC ships have been repaired in Canada in recent years?

3. When Canadian companies bid for a Navy ship repair work, are they subject to the same statutory and regulatory guidelines that U.S. bidders must comply with?

4. Are there any restrictions existing on foreign procurement when competitive domestic contractors are available?

APPENDIX I

5. Do Canadian companies that bid for Navy contracts receive any assistance from the Canadian government in the bid preparation process? If so, does the shipyard reimburse the Canadian government for the value of this assistance? Does the shipyard itself submit bids, or does the Canadian government, or an entity of the government, submit the bids on the yard's behalf? Does the shipyard benefit any other way from Canadian government assistance?

6. When a Canadian yard bids for U.S. government military work, does it do so in terms of U.S. dollars or Canadian dollars? Are contract bids subject to adjustment as the result of differences in the exchange rate?

7. Do the U.S. and Canada have a special arrangement with regard to military contracting? Can U.S. shipyards bid for Canadian government ship overhaul and maintenance work? Have U.S. shipyards participated in competitive bidding for Canadian government ship repair work in the recent past?

I wish to thank you for the assistance of your staff, including Vincent Griffith, pursuant to my earlier letter. I hope that this letter will be of assistance in defining the objectives of the audit.

Sincerely,

Bob Packwood

BOB PACKWOOD

BP/pfg

LETTER OF AGREEMENT WITH CANADA

1. This agreement applies to all contracts placed, on or after October 1, 1956, by any of the Military Departments with the Corporation. It shall remain in force from year to year until terminated by mutual consent; however, it can be terminated on the 31st day of December or the 30th day of June in any year by either party provided that six months notice of termination has been given in writing. In addition, this agreement provides for certain reciprocal arrangements facilitating procurement by each of the parties in the country of the other.

2.(a) The Corporation agrees that it will cause all first-tier subcontracts under contracts covered by this agreement to be placed in accordance with the practices, policies, and procedures of the Government of Canada covering procurement for defence purposes; and agrees that if the aggregate profit realized under such subcontracts by any first-tier subcontractor exceeds that which is allowed by the Government of Canada under the above mentioned practices, policies, and procedures, the amount of such excess will be refunded by the Corporation to the Military Departments. There shall also be refunded profits on any subcontract in excess of amounts which the Minister of Defence Production (Canada) in the exercise of said practices, policies and procedures considers to be fair and reasonable, recovered by the Minister pursuant to Section 21 of the Defence Production Act (Canada) from any individual subcontractor of any tier. It is recognized that the practices, policies and procedures of the Government of Canada referred to above permit various rates of profit in accordance with the terms of the said practices, policies, and procedures as from time-to-time amended; however, in no case will the rate of profit be allowed to exceed any limit prescribed by statute of the Government of the United States. For the purpose of this paragraph, the Corporation will cause to be conducted such audits in accordance with the Costing Memorandum (DDP-31) of the Department of Defence Production (Canada) and such verifications of cost as are in accordance with the said practices, policies, and procedures. The Corporation will render to the Military Departments its certificate that the provisions of this paragraph have been observed.

Source: DFARS, appendix T-201.1.

APPENDIX II

(b) Contracts for communication and transportation services, and the supply of power, water, gas and other utilities shall be excepted from the provisions of subparagraph (a) above, provided the rate or charges for such services or utilities are fixed by public regulatory bodies; and provided further the Military Departments are accorded any special rates that may be available to the Canadian Government with respect to such contracts.

(c) The Canadian Government, its Department and Agencies, including but not limited to the Corporation and Canadian Arsenals Limited, a Crown Company wholly owned by the Canadian Government, shall not be entitled to any profit on any contract or contracts covered by this agreement. Any profits which may be realized shall be returned to the Military Departments except as hereinafter provided: Before refunding profits realized from the following sources:

(i) net profits of the Canadian Government, its Departments and Agencies, as defined above, with respect to contracts and subcontracts covered by this agreement.

(ii) excess profits referred to in paragraph (a) above, and

(iii) renegotiation recoveries from subcontracts of any tier under contracts covered by this agreement, which recoveries the Military Departments would otherwise be entitled to receive in accordance with the provisions of subparagraph (a) above;

the Corporation shall be entitled to deduct any losses it may sustain with respect to contracts covered by this agreement.

(d) Interim adjustments and refunds under this paragraph 2 shall be made at such time or times as may be mutually agreed upon but at least once a year as of June 30th. Such interim adjustments shall apply only to completed contracts. The final adjustment and refund shall be made as soon as practicable after the expiration of this agreement.

(e) The profit and loss provisions of this paragraph 2 shall not apply to contracts awarded to the Corporation as the result of formal competitive bidding (initiated by Invitation for Bids).

3.(a) All contracts placed by the Military Departments with the Corporation, except those placed as the result of formal competitive bidding, shall provide for prices or cost reimbursement, as the case may be, in terms of Canadian currency, and for payment to be made in such currency. Therefore, quotations and invoices shall be submitted by the Corporation to the Military Departments in terms of Canadian currency, and such cost data, vouchers, etc., as the contracts require shall also be submitted in terms of Canadian currency. However, the Corporation may elect in respect of any of such contracts to quote, submit the said cost data, vouchers, etc., and receive payment in United States currency, in which event such contracts shall provide for payment in United States currency and shall not be subject to adjustment for losses or gains resulting from fluctuations in exchange rates.

APPENDIX II

(b) All formal competitive bids shall be submitted by the Corporation in terms of United States currency and contracts placed as a result of such formal competitive bidding shall not be subject to adjustment for losses or gains resulting from fluctuation in exchange rates.

4. The Military Departments and the Corporation shall avoid, to the extent consistent with the declared policies of the Military Departments and the Canadian Government, the making of any surcharges covering administration costs with respect to contracts placed with the Corporation by any of the Military Departments and contracts placed by the Military Departments in the United States for the Canadian Government.

5. To the extent that contracts placed with the Corporation by the Military Departments provide for the audit of costs and profits, such audit will be made without charge to the Military Departments by the Cost Inspection and Audit Division of the Treasury of Canada in accordance with Costing Memorandum Form DDP-31 of the Department of Defence Production, Canada.

6. The Canadian Government shall arrange for inspection personnel of the Department of National Defence (Canada) to act on behalf of the Military Departments with respect to contracts placed by the Military Departments with the Corporation and with respect to subcontracts placed in Canada by United States contractors which are performing contracts for the Military Departments, and for the use of inspection facilities of the Department of National Defence (Canada) for such purposes, such personnel and facilities to be provided without cost to the Military Departments. The Military Departments shall provide and make no charge for inspection services and inspection facilities in connection with contracts placed in the United States by the Military Departments for the Canadian Government and with respect to subcontracts placed in the United States by Canadian contractors which are performing contracts for the Department of Defence Production* (Canada). The Department of National Defence (Canada) or any Military Department may provide liaison with the other's inspection personnel in connection with the foregoing. It is understood that either the Department of National Defence (Canada) or any Military Department may in appropriate cases arrange inspection by its own inspection organization in the other's country.

7. Because of the varying arrangements made by the Canadian Government and the Military Departments in furnishing Government-owned facilities (including buildings and machine tools) to contractors, it is recognized that the matter of inclusion in contract prices of charges, through amortization or otherwise, for use of such facilities will be determined in the negotiation of individual contracts. However, there shall be avoided, to the extent consistent with the policies of the Canadian Government and Military Departments, any such charges for use of Government-furnished facilities.

APPENDIX II

8.(a) The Corporation agrees that the prices set out in fixed-price type contracts covered by this Agreement will not include any taxes with respect to first-tier subcontracts; nor shall prices include custom duties to the extent refundable in accordance with Canadian law, paid upon the import of any materials, parts, or components incorporated or to be incorporated in the supplies, with respect to first-tier subcontracts.

(b) The Corporation agrees that under cost-reimbursement type contracts the Corporation shall, to the extent practicable with respect to first-tier subcontracts, exclude from its claims all taxes and to the extent refundable in accordance with Canadian Law, customs duties, paid upon the import of any materials, parts or components, incorporated or to be incorporated in the supplies and that any amounts included in such claims representing such taxes and duties shall be refunded or credited to the Military Departments.

(c) The Corporation agrees that to the extent that such taxes and duties can be reasonably and economically identified it will use its best endeavors to cause such taxes to be excluded from all subcontracts below the first tier and if found to be included to be recoverable and credited to the Military Departments.

9. The Corporation recognizes that existing law of the United States prohibits the use of the cost-plus-a-percentage-of-cost system of contracting.

10. Each contract covered by this agreement shall be deemed to include the provisions required by (i) Public Law 245, 82nd Congress of the United States (65 Stat. 700; 41 USC 153(c)) and (ii) Section 719 of Public Law 458, 83rd Congress of the United States (68 Stat. 353) or similar provisions that may be required by subsequent legislation.

(End of Agreement)

* now the Department of Supply and Services

THE OVERALL DEFENSE PRODUCTION ARRANGEMENT

The military contracting agreement of 1952 was proposed because of increased purchasing of supplies in Canada by U.S. military departments and the need to further implement an October 26, 1950, agreement between the United States and Canada on industrial mobilization. This 1950 agreement (see app. XII), which is still in effect, was approved by the President on September 20, 1950, as the basis for joint economic cooperation with Canada. The agreement states its objectives as

> "...our two governments shall cooperate...to the end that the economic efforts of the two countries be coordinated for the common defense and that the production and resources of both countries be used for the best combined results."

In addition, the agreement gives formal effect to a Statement of Principles for Economic Cooperation, which includes consideration of (1) a coordinated program of requirements, production, and procurement, (2) coordinated controls over the distribution of scarce raw materials, (3) consultation on emergency controls, (4) the free exchange of technical knowledge and productive skills, (5) the removal of barriers which impede the flow of goods essential for the common defense effort, and (6) consultation on financial or foreign exchange problems. The discussions that led to the October 1950 agreement were based on concepts of economic cooperation inherent in the Hyde Park Agreement of 1941.

The Hyde Park Agreement (see app. XIII), which is still in effect, is a joint statement that was issued at Hyde Park, New York, on April 20, 1941, by President Franklin D. Roosevelt and Prime Minister W. L. Mackenzie King concerning the exchange of defense articles. This agreement:

- --States that in mobilizing the resources of this continent, each country should provide the other with the defense articles that it is best able to produce, and, above all, produce quickly, and that production programs should be coordinated to this end.

- --Recognizes the importance to the economic and financial relations between the two countries of payment by the United States for supplies purchased in Canada to materially assist Canada in paying for its increasing defense purchases in the United States.

--Was preceded by an earlier joint statement issued by President Roosevelt and Prime Minister King at Ogdensburg, New York, on August 18, 1940, which established a Permanent Joint Board on Defense to consider the defense of the north half of the Western Hemisphere. (The text of the statement appears in Department of State Bulletin, vol. III, No. 61, August 24, 1940, p. 154.)

--Was extended into the post-war period by a May 1945 agreement, which continued its principles to the reconversion of industry from war to peace. (The text of the agreement appears in the Department of State's "Treaties and Other International Acts Series" (TIAS) 1752.)

The Statement of Principles for Economic Cooperation is implemented, in part, by what has come to be known as the U.S.-Canada Defense Production Sharing Program, which was established in 1959. According to the Director of International Acquisition in the Office of the Assistant Secretary of Defense (Acquisition and Logistics), the scope of the U.S.-Canada Defense Production Sharing Program extends to ship repair contracts.

Further agreements and policy guidance, and a 1958 report of the House Committee on Foreign Affairs, provide additional evidence relating to the origins of this program and its development over the years. For example, on April 12, 1949, the United States and Canada established a Joint Industrial Mobilization Committee to exchange information and make recommendations in areas of common concern. (The text of the agreement appears in TIAS 1889.)

On November 27, 1951, DOD Directive 600.12-1, concerning joint industrial mobilization cooperation with Canada, was issued. The November 4, 1980, revision of this directive, which is currently effective and is now numbered 2035.1, states the policy of the United States to maintain and strengthen defense economic cooperation with Canada. This policy is based on the recognition that the United States and Canada have a mutual interest in the defense of North America, and is consistent with their responsibilities as partners in the North Atlantic Treaty Organization. The stated objectives of the policy are to

"a. Promote a strong, integrated, and more widely dispersed defense industrial base in North America.

b. Achieve the most economical use of research and development (R&D) and production resources.

c. Foster greater standardization and interoperability of military equipment.

d. Remove obstacles to the free flow of defense equipment trade.

e. Encourage the exchange of information and technology.

f. Accord equal consideration to the business communities of both countries."

According to the Country Director for Canada in the Office of the Assistant Secretary of Defense for International Security Policy, the directive helps to implement the U.S.-Canada Defense Production Sharing Arrangement and contracting for ship repairs in Canada falls under the directive's objectives "a" and "f" stated above. The directive further states that:

> "In pursuit of this policy, the United States and Canada have agreed that their defense economic relationship shall be administered in such a manner as to ensure the maintenance of a long-term balance at the highest practicable level in the reciprocal purchase of items of mutual defense interest. This agreement is based on the principle of equity rather than symmetry, and recognizes the differences in capabilities and capacities of the defense-oriented industries in the two countries and the relative sizes, structures, and materiel requirements of the U.S. and Canadian armed forces. Furthermore, Canadian industry is uniquely recognized as an element of the industrial base..."

A December 19, 1958, Second Report of the Special Study Mission to Canada of the House Committee on Foreign Affairs also addressed defense cooperation with Canada. A recommendation in this report not only provided some congressional support for the program as it was developing but also summarized the principal reason for the program. The recommendation stated that:

> "In view of the increased Canadian reliance on United States produced weapons, particularly in the missile and other advanced categories, consideration should be given by the Department of Defense to permitting greater access by the Canadians to United States defense procurement contracts. The Canadians have extensive capabilities in the components field and if the Canadians are going to purchase from us, then we should, in turn, permit them to participate in the components business. It is suggested that

> consideration be given to the means whereby such an end can be secured; specifically, to the question of the applicability of the 'Buy American' statutes to procurement in Canada and to improved procedures to inform Canadian manufacturers of proposed procurements and of invitations to bid. The recently established Canada-United States Ministerial Committee on Joint Defense, which is to be composed of representatives of the United States and Canadian defense agencies, would appear to be an appropriate vehicle for discussing this proposition and for laying some sort of groundwork for positive action."

(See app. XIV for an extract from the report which summarizes the detailed facts and circumstances which led to the recommendation.)

On December 30, 1958, the President approved the following policy statement in National Security Council policy paper NSC 5822/1, which concerned certain aspects of U.S. relations with Canada.

> "Take steps, as feasible, to assure Canada a fair opportunity to share in the production of military equipment and materiel involving programs of mutual interest to Canada and the United States, and in the research and development connected therewith. Such steps, to the extent practicable, should include measures to: (a) promote closer integration of U.S. and Canadian military production; (b) provide for the necessary flow of information to Canadian firms; (c) insure the most economical use of defense funds; and (d) accord equal consideration to the business communities of both countries."

(See app. XV for extracts from the policy paper,[1] including the discussion leading to the policy statement.)

On June 6, 1963, the Secretary of Defense and the Canadian Minister of Defence Production agreed to various matters concerning the long-term balance in reciprocal procurement. (See GAO/C-NSIAD-87-1FS, a classified document.)

On November 21, 1963, the Secretary of Defense and the Canadian Minister of Defence Production established a cooperative agreement on defense research and development called the Defense Development Sharing Program. The Memorandum of Understanding setting forth the agreement, which is still in force, states that it complements the Defense Production Sharing Program. The agreement superseded prior arrangements with the

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[1]On recommendation of the Secretary of State, the President authorized the recission of NSC 5822/1, effective January 12, 1962.

Army (July 26, 1960) and the Air Force (December 22, 1961). (The text of the agreement appears in DFARS, appendix T, subpart T-201.2.)

On August 7, 1965, the Assistant Secretary of Defense (Installations and Logistics) (I&L) issued a memorandum to the Assistant Secretaries (I&L) of the military departments on maintaining balanced defense trade under the U.S.-Canada Production Sharing Program. The memorandum stated:

> "...the Canadian Government has announced long-range defense procurement plans calling for substantial expenditures in the United States during the next few years. While at present the balance under the U.S.-Canada Production Sharing Program stands in favor of Canada, the projected Canadian procurement program could result in a reversal of the balance and, ultimately, in a serious imbalance in favor of the United States unless offset by U.S. defense purchases in Canada.
>
> "In view of the above, one of the purposes of this memorandum is to reiterate the need for continuing efforts to assure that the long term balance under the production sharing program is maintained. Cognizant I&L activities are requested to give renewed attention to assuring effective implementation of procedures designed (1) to keep Canada well informed of U.S. defense requirements in both the R&D and production areas and (2) to assure Canadian firms full opportunity...to participate in the resultant contracts and subcontracts."

On October 21, 1970, the Assistant Secretary of Defense (I&L) and the President of the Canadian Commercial Corporation agreed to certain U.S./Canada mobilization production planning arrangements. The arrangements relate specifically to participation of Canadian industry in the U.S. Industrial Mobilization Production Planning Program, possible planning activities with U.S. firms for Canadian requirements, and subcontract planning related to U.S. requirements.

The Defense Production Sharing Program has also been recently reaffirmed by the two governments. On October 4, 1984, a joint statement by the Secretary of Defense and the Minister of National Defence of Canada stated:

> "The Ministers agreed that economic strength was essential as a foundation for a strong defence effort. In this connection, they reviewed the defence development and defence production sharing arrangements between the two countries. Secretary Weinberger spoke of the value which the United States Department of Defence attaches to a high quality input by Canadian enterprise to the overall North American defence

APPENDIX III

industrial base. The Ministers reaffirmed the existing understanding that defence trade between Canada and the United States under the Defence Development and Defence Production Sharing Arrangements should be maintained in balance over time. They both agreed to seek ways to increase both the volume and the sophistication of United States defence procurement in Canada."

Based on the Quebec Summit, on March 18, 1985, the President and the Prime Minister of Canada issued a declaration regarding international security, which stated:

"To provide for an effective use of resources and to aid both of our countries in bearing our share of the Allied defence burden, we reaffirm the Canada/United States Defence Development and Production Sharing Arrangements and agree to strengthen our North American defence industrial base. Recognizing the importance of access to, and participation of, Canadian firms in the U.S. defence market, we will work to reduce barriers, and to stimulate the flow in defence goods."

THE CANADIAN COMMERCIAL CORPORATION

Summary The CCC, a Canadian Crown Corporation, was established in 1946 to develop trade. It acts as a prime contracting agency when other countries want to purchase supplies and services from the Canadian government. The CCC, in turn, subcontracts the entire requirement to Canadian firms. Sales to the United States, which amounted to $670 million during the fiscal year ended March 31, 1985, are the CCC's major source of contracting activity.

Facts

The Letter of Agreement of February 26, 1952, between the United States and Canada on military contracting stated that the CCC was established by an Act of Parliament of Canada in 1946 and is wholly owned by the Government of Canada, and its acts are binding on the Crown. The Canadian Commercial Corporation Act (Revised Statutes of Canada 1970, as amended to December 31, 1984) contains the following provisions concerning the CCC's status and objectives.

"The Corporation is for all its purposes an agent of Her Majesty in right of Canada." (Sec. 3(3))

"The Corporation is established for the following purposes:

(a) to assist in the development of trade between Canada and other nations;

(b) to assist persons in Canada

(i) to obtain goods and commodities from outside Canada, and

(ii) to dispose of goods and commodities that are available for export from Canada;..." (Sec. 4(1))

"The Corporation...may carry on the business of

(a) importing goods or commodities into Canada; and

(b) exporting goods or commodities from Canada; either as principal or as agent, in such manner and to such extent as it deems advisable to achieve the said purposes." (Sec. 5(1))

APPENDIX IV

The export role of the CCC is described as follows in its Annual Report 1983-84.

> "...the Corporation: facilitates exports of a wide range of goods and services from Canadian sources, by serving as prime contractor in government-to-government transactions;...
>
> "...CCC, as principal, purchases goods and services from Canadian sources through back-to-back contracts and sells them to customers abroad. Through an arrangement made between the Corporation and Supply and Services Canada, the bulk of these contracts are transacted in the Corporation's name..."

With regard to its export role, the Annual Report 1984-85 indicated that:

--Since its inception, the CCC has facilitated over $12 billion in exports.

--The CCC generated 2,329 contracts and amendments valued at $781 million during the fiscal year on behalf of more than 75 foreign customers and 300 Canadian exporters.

--Sales of defense items to the United States, under the U.S.-Canada Defense Production and Development Sharing Arrangements, totaled $670 million during the year and continued to be the CCC's major source of contracting activity.

APPENDIX V

LIST OF NAMES AND OTHER DATA CONCERNING SHIPS FOR WHICH MSC WAS RESPONSIBLE FOR REPAIR ON JULY 15, 1985

Ship classification[a]	MSC ship Number[b]	Name	MSC Area Command[c]	Repaired in Canada
AE (ammunition)	T-AE 26	USNS Kilauea	PAC	No
AF (store)	T-AF 58	USNS Rigel	LANT	No
AFS (combat store)	T-AFS 10	USNS Saturn	LANT	No
	T-AFS 8	USNS Sirius	LANT	No
	T-AFS 9	USNS Spica	PAC	Yes
AG (miscellaneous)	T-AG 194	USNS Vanguard	LANT	No
AGM (missile range instrumentation)	T-AGM 23	USNS Island Observation	PAC	No
	T-AGM 22	USNS Range Sentinel	LANT	No
	T-AGM 20	USNS Redstone	LANT	No
AGOR (oceanographic research)	T-AGOR 13	USNS Bartlett	LANT	No
	T-AGOR 12	USNS De Steiguer	PAC	No
	T-AGOR 16	USNS Hayes	LANT	No
	T-AGOR 7	USNS Lynch	LANT	No
	T-AGOR 11	USNS Mizar	PAC	No
AGS (surveying)	T-AGS 26	USNS Silas Bent	PAC	No
	T-AGS 21	USNS Bowditch	LANT	No
	T-AGS 29	USNS Chauvenet	PAC	No
	T-AGS 22	USNS Dutton	LANT	No
	T-AGS 32	USNS Harkness	LANT	No
	T-AGS 38	USNS H H Hess	LANT	No
	T-AGS 27	USNS Kane	LANT	No
	T-AGS 33	USNS Wilkes	LANT	No
	T-AGS 34	USNS Wyman	LANT	Yes
AK (cargo)	T-AK 280	USNS Furman	LANT	No
	T-AK 282	USNS Marshfield	LANT	No
	T-AK 286	USNS Vega	LANT	No
AKR (vehicle cargo)	T-AKR 11	USNS Jupiter	PAC	No
	T-AKR 10	USNS Mercury	PAC	No
	T-AKR 9	USNS Meteor	PAC	No
AO (oiler)	T-AO 145	USNS Hassayampa	PAC	No
	T-AO 146	USNS Kawishiwi	PAC	Yes
	T-AO 105	USNS Mispillion	PAC	No
	T-AO 144	USNS Mississinewa	LANT	No
	T-AO 106	USNS Navasota	PAC	No
	T-AO 143	USNS Neosho	LANT	No
	T-AO 107	USNS Passumpsic	PAC	No
	T-AO 108	USNS Pawcatuck	LANT	No
	T-AO 148	USNS Ponchatoula	PAC	No
	T-AO 147	USNS Truckee	LANT	No
	T-AO 109	USNS Waccamaw	LANT	Yes

APPENDIX V

Ship classification[a]	MSC ship Number[b]	Name	MSC Area Command[c]	Repaired in Canada
ARC (cable repairing)	T-ARC 6	USNS Albert J. Myer	PAC	No
	T-ARC 2	USNS Neptune	PAC	Yes
	T-ARC 7	USNS Zeus	PAC	Yes
ATF (fleet ocean tug)	T-ATF 172	USNS Apache	LANT	No
	T-ATF 168	USNS Catawba	PAC	No
	T-ATF 170	USNS Mohawk	LANT	No
	T-ATF 167	USNS Narragansett	PAC	No
	T-ATF 169	USNS Navajo	PAC	No
	T-ATF 166	USNS Powhatan	LANT	No
	T-ATF 171	USNS Sioux	PAC	No

[a]As set forth in Secretary of the Navy Instruction 5030.1J.

[b]The letter prefix "T" indicates a ship assigned to MSC.

[c]Assignment of ship to Atlantic (LANT) or Pacific (PAC) Area Command as of October 1, 1985.

STATUS OF MSRAs BETWEEN THE NAVY AND CANADIAN SHIPYARDS AS OF MARCH 10, 1986

As shown in table VI.1, as of March 10, 1986, MSC had signed MSRAs with four Canadian shipyards and had received three additional MSRA applications from Canadian shipyards. As of that same date, NAVSEA had not signed MSRAs with any Canadian shipyards, but had received an MSRA application from a Canadian shipyard and an expression of interest in obtaining an MSRA from another.

Table VI.1: Status of MSRAs with Canadian Shipyards

Canadian shipyard[a]	MSRA status as of March 10, 1986 MSC	NAVSEA
1. Halifax Industries Limited Halifax Shipyard Halifax, Nova Scotia	Signed by MSC	-
2. Marine Industries Limited Sorel (Tracy), Quebec	Signed by MSC	Applied to NAVSEA 8/8/85
3. Port Weller Dry Docks St. Catharines, Ontario	Applied to MSC 2/26/85	-
4. Saint John Shipbuilding & Dry Dock Co. Ltd. Saint John, New Brunswick	Applied to MSC 3/29/85[b]	Interest expressed to NAVSEA Feb. 1986
5. Versatile Davie Inc. (formerly Davie Shipbuilding Limited) Levis, Quebec	Signed by MSC	-
6. Versatile Pacific Shipyards Inc. (formerly Burrard Yarrows Corporation) North Vancouver, British Columbia	Signed by MSC	-
7. Versatile Vickers Inc. Montreal, Quebec[c]	Applied to MSC 4/8/85	-

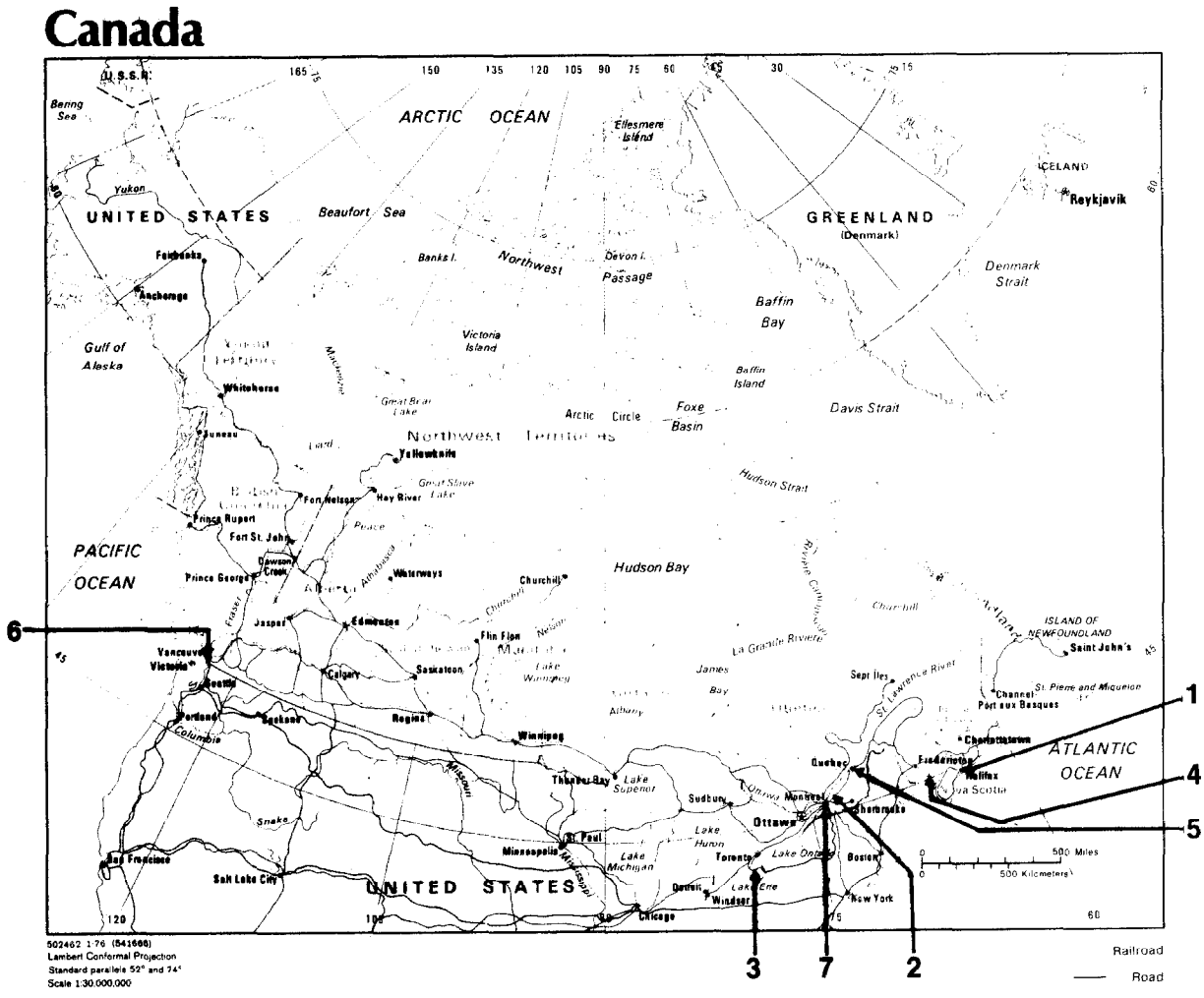
[a]The number associated with each shipyard corresponds to its location as shown in figure VI.1.

[b]MSRA signed by MSC subsequent to March 10, 1986.

[c]The company stated in a September 1, 1982, letter to MSC that "on a number of occasions we have overhauled or repaired ships for the U.S. Coast Guard, the U.S. Army Corps of Engineers, etc."

APPENDIX VI

Figure VI.1: Map of Canada Showing Locations of Canadian Shipyards Interested in Repairing U.S. Navy Ships



APPENDIX VII

NUMBER OF SHIP REPAIR CONTRACTS AWARDED TO U.S. AND CANADIAN SHIPYARDS BY MSC'S ATLANTIC AND PACIFIC AREA COMMANDS

Table VII.1: Total Contracts Awarded by Atlantic and Pacific Area Commands

Fiscal year	Total		United States		Canadian	
	No.	Percentage	No.	Percentage	No.	Percentage
1980	173	100.0	172	99.4	1	0.6
1981	154	100.0	154	100.0	-	-
1982	272	100.0	271	99.6	1	.4
1983	214	100.0	214	100.0	-	-
1984	159	100.0	159	100.0	-	-
1985	79	100.0	74	93.7	5	6.3
1986[a]	11	100.0	10	90.9	1	9.1
Total	1,062	100.0	1,054	99.2	8	.8

Table VII.2: Contracts Awarded by Atlantic Area Command

Fiscal year	Total	United States	Canadian
1980	120	119	1
1981	114	114	-
1982	208	207	1
1983	175	175	-
1984	127	127	-
1985	49	47	2
1986	4	4	-
Total	797	793	4

Table VII.3: Contracts Awarded by Pacific Area Command

Fiscal year	Total	United States	Canadian
1980	53	53	-
1981	40	40	-
1982	64	64	-
1983	39	39	-
1984	32	32	-
1985	30	27	3
1986	7	6	1
Total	265	261	4

[a]As of December 6, 1985.

PRICE OF SHIP REPAIR CONTRACTS AWARDED TO U.S. AND CANADIAN SHIPYARDS BY MSC'S ATLANTIC AND PACIFIC AREA COMMANDS

Table VIII.1: Total Price of Contracts Awarded by Atlantic and Pacific Area Commands

Fiscal year	Total		United States		Canadian	
	Price	Percentage	Price	Percentage	Price	Percentage
1980	$111,923,186	100.0	$110,356,024	98.60	$ 1,567,162	1.40
1981	53,156,444	100.0	53,156,444	100.00	-	-
1982	57,486,805	100.0	57,482,736	99.99	4,069	.01
1983	55,819,508	100.0	55,819,508	100.00	-	-
1984	42,621,309	100.0	42,621,309	100.00	-	-
1985	52,589,767	100.0	44,767,531	85.13	7,822,236	14.87
1986[a]	10,281,416	100.0	9,496,201	92.36	785,215	7.64
Total	$383,878,435	100.0	$373,699,753	97.35	$10,178,682	2.65

Table VIII.2: Price of Contracts Awarded by Atlantic Area Command

Fiscal year	Total	United States	Canadian
1980	$ 47,619,763	$ 46,052,601	$1,567,162
1981	36,700,434	36,700,434	-
1982	32,083,904	32,079,835	4,069
1983	35,572,029	35,572,029	-
1984	28,345,989	28,345,989	-
1985	31,394,657	31,117,357	277,300
1986[a]	1,528,185	1,528,185	-
Total	$213,244,961	$211,396,430	$1,848,531

Table VIII.3: Price of Contracts Awarded by Pacific Area Command

Fiscal year	Total	United States	Canadian
1980	$ 64,303,423	$ 64,303,423	$ -
1981	16,456,010	16,456,010	-
1982	25,402,901	25,402,901	-
1983	20,247,479	20,247,479	-
1984	14,275,320	14,275,320	-
1985	21,195,110	13,650,174	7,544,936
1986[a]	8,753,231	7,968,016	785,215
Total	$170,633,474	$162,303,323	$8,330,151

[a]As of December 6, 1985.

APPENDIX IX

SUMMARY OF MSC, PACIFIC, BID EVALUATIONS

FOR FOUR SHIP REPAIR CONTRACTS AWARDED TO A CANADIAN SHIPYARD

Name of offeror	Basic bid		Interport differential[b]	Evaluated bid		Remarks
	Price[a]	Percentage of Canadian price		Price[c]	Percentage of Canadian price	
Ship:						
USNS Neptune (T-ARC 2)			(d)			
Type of Work: Drydocking/Topside/Sponsor Modifications/American Bureau of Shipping Survey/and U.S. Coast Guard Recertification						
Burrard Yarrows Corp. N. Vancouver, B.C., Canada	$ 734,563	100.0	-	$ 734,563	100.0	Successful bid
Dillingham Ship Repair Portland, Oreg.	889,126	121.0	-	889,126	121.0	Lowest, responsive U.S. bid
Todd Shipyards Corp. San Francisco, Calif.	994,440	135.4	-	994,440	135.4	-
Northwest Marine Iron Works Portland, Oreg.	1,188,000	161.7	-	1,188,000	161.7	(e)
Todd Pacific Shipyards Corp. Seattle, Wash.	1,227,373	167.1	-	1,227,373	167.1	-
Triple "A" Machine Shop, Inc. San Francisco, Calif.	1,271,886	173.1	-	1,271,886	173.1	-
Southwest Marine, Inc. San Diego, Calif.	1,498,513	204.0	-	1,498,513	204.0	-
Ship:						
USNS Spica (T-AFS 9)						
Type of Work: Post Shakedown Availability Drydocking and Topside						
Burrard Yarrows Corp. N. Vancouver, B.C., Canada	3,111,526[f]	100.0	$61,813	3,173,339	100.0	Successful bid[g]
Dillingham Ship Repair Portland, Oreg.	3,498,046	112.4	50,710	3,548,756	111.8	(h)
Todd Shipyards Corp. San Francisco, Calif.	4,130,780	132.8	-	4,130,780	130.2	(h)
Todd Pacific Shipyards Corp. Seattle, Wash.	4,185,261	134.5	59,556	4,244,817	133.8	Lowest, responsive U.S. bid
Northwest Marine Iron Works Portland, Oreg.	4,257,104	136.8	50,710	4,307,814	135.8	(e)
Triple "A" Machine Shop, Inc. San Francisco, Calif.	5,348,589	171.9	-	5,348,589	168.5	-

APPENDIX IX

Name of offeror	Basic bid Price[a]	Basic bid Percentage of Canadian price	Interport differential[b]	Evaluated bid Price[c]	Evaluated bid Percentage of Canadian price	Remarks
Ship:						
USNS Kawishiwi (T-AO 146)						
Type of Work: Regular overhaul and drydocking						
Versatile Pacific Shipyards Inc. N. Vancouver, B.C., Canada	$2,643,491	100.0	$51,505	$2,694,996	100.0	Successful bid
Dillingham Ship Repair Portland, Oreg.	2,685,233	101.6	42,853	2,728,086	101.2	Lowest, responsive U.S. bid
Southwest Marine, Inc. San Diego, Calif.	2,956,200	111.8	-	2,956,200	109.7	-
Todd Shipyards Corp. San Francisco, Calif.	3,194,005	120.8	15,581	3,209,586	119.1	-
Northwest Marine Iron Works Portland, Oreg.	3,272,533	123.8	42,853	3,315,386	123.0	-
Triple "A" Machine Shop, Inc. San Francisco, Calif.	3,368,945	127.4	15,581	3,384,526	125.6	-
Continental Maritime of San Francisco, Inc. San Francisco, Calif.	3,557,907	134.6	15,581	3,573,488	132.6	-
Todd Pacific Shipyards Corp. Seattle, Wash.	3,945,594	149.3	48,678	3,994,272	148.2	-
Ship:						
USNS Zeus (T-ARC 7)			(d)			
Type of Work: Drydock/Topside/ Sponsor Recertification						
Versatile Pacific Shipyards Inc. N. Vancouver, B.C., Canada	785,215	100.0	-	785,215	100.0	Successful bid
Lockport Marine Co. Portland, Oreg.	828,791	105.5	-	828,791	105.5	Lowest, responsive U.S. bid
Dillingham Ship Repair Portland, Oreg.	995,220	126.7	-	995,220	126.7	-
Todd Shipyards Corp. San Francisco, Calif.	1,160,190	147.8	-	1,160,190	147.8	-

[a]The basic price of a bid is the total price for all category A items and category B items, if any. Category A items are items of work that are to be accomplished by the successful bidder. Category B items are those items of work that may or may not be ordered, depending upon the need for the vessel, urgency of work, price and other such factors, and are to be determined solely by the contracting officer. During performance of category A items, the government determines whether category B items are required and in what quantity.

[b]According to MSC Headquarters Instruction 4330.21C:

> "When the solicitation area is not restricted to one port area, interport differentials representing the probable additional cost to be incurred by the Government by reason of repair in each specific port will be computed. The appropriate differentials will be applied to the respective bids or offers for the purpose of evaluation."

Interport differentials (IPDs) consider various elements of cost, including ship operating costs; inspection costs; tugs and towage; pilotage and canal fees; and crew repatriation, subsistence, and quarters costs.

In developing its IPDs, MSC, Pacific, used a "zero" point that was developed after calculations of the total cost to the different areas. The lowest area became the common differential or zero point. This common differential was subtracted from all other area costs. The difference to the common area became the IPD.

The Navy's use of the IPD, however, has been restricted by the Congress. Section 8104 of Public Law 99-190 (the Department of Defense Appropriations Act, 1986) states that:

> "None of the funds available to the Department of the Navy may be used to enter into any contract for the overhaul, repair, or maintenance of any naval vessel on the West Coast of the United States which includes charges for interport differential as an evaluation factor for award."

A similar but broader restriction appeared in the Supplemental Appropriations Act, 1985 (Public Law 99-88, August 15, 1985). That restriction contained the same language as quoted above but did not include the words "on the West Coast of the United States."

[c]The evaluated bid price is the price resulting from application of IPDs, if any, to the basic bid price.

[d]An IPD was not used as a bid evaluation factor because the ship was at sea and could proceed directly to any contractor's plant before returning to sea.

[e]Bid was nonresponsive because it did not include a required bid bond.

[f]Bid price for category A included $76,000 for a category B item.

[g]Bid was determined to be nonresponsive by the Comptroller General in a bid protest decision (B-218653, August 14, 1985) because the contractor did not submit a price for a category B item. Also see footnote f.

Further, our current review of the documentation in the contract file disclosed that the CCC (the prime contractor) endorsed the bid after bid opening, rather than before, as required by paragraph 25.7104(a)(2)(ii) of the DFARs, which is quoted herein in section 4 under "Bidding Procedures."

[h]Bid was nonresponsive because it did not bid separate prices for certain category B subitems.

SMALL BUSINESS SET-ASIDE SHIP REPAIR CONTRACTS AWARDED BY MSC'S ATLANTIC AND PACIFIC AREA COMMANDS

Table X.1: Total Small Business Contracts Awarded by Atlantic Area Command

Fiscal year	Total contracts	Small business set-aside contracts	Percentage set aside
1980	120	112	93
1981	114	76	67
1982	208	187	90
1983	175	155	89
1984	127	120	94
1985	52[a]	47	90
1986[b]	4	4	100
Total	800	701	88

Table X.2: Total Small Business Contracts Awarded by Pacific Area Command

Fiscal year	Total contracts	Small business set-aside contracts	Percentage set aside
1980	53	23	43
1981	40	16	40
1982	64	22	34
1983	39	19	49
1984	32	26	81
1985	30	19	63
1986[b]	7	4	57
Total	265	129	49

[a]Includes three contracts awarded to other than a U.S. or Canadian shipyard.

[b]As of December 6, 1985.

APPENDIX XI

MSC LETTER CONCERNING CONTRACT CLAUSES NOT NORMALLY APPLICABLE TO MSRAs WITH THE CCC

DEPARTMENT OF THE NAVY
OFFICE OF THE GENERAL COUNSEL

Counsel for the
Military Sealift Command
Washington, D.C. 20390

5800
Ser M-7/
14 JAN 1986

Mr. Warren Nagel
National Security and International Affairs Division
United States General Accounting Office
Washington, D. C. 20543

Dear Mr. Nagel:

In response to your inquiry concerning Navy ship repair contracts with Canadian shipyards the Military Sealift Command (MSC) has reviewed contract clauses applicable to Master Ship Repair Agreements (MSRA) between the Canadian Commercial Corporation (CCC) and MSC.

Contracts for the repair and alteration of Navy vessels assigned to MSC are performed in Canada pursuant to the DOD FAR SUPPLEMENT Part 17.71 et seq. and Part 25.71 et seq. Contract clauses for inclusion in an MSRA are located at DOD FAR SUPPLEMENT Section 17.7104. The policy stated at DOD FAR SUPPLEMENT Section 17.7102 is that the Contracting Officer shall include in an MSRA with a prospective contractor located outside the United States only those contract clauses from Section 17.7104 determined to be applicable. On the basis of our review, MSC has determined that the following FAR clauses should not normally be included in an MSRA with the CCC for ship repair work to be performed solely in Canada. However, as noted above, the Contracting Officer has discretion in this matter.

§ 17.7104(a) (16) 52.217-7115
- CONTRACT WORK HOURS AND SAFETY STANDARDS ACT - OVERTIME COMPENSATION
- Clause does not apply to contracts performed in a foreign country, see 22.305(a)(4).

(17) 52.217-7116
- WALSH-HEALEY PUBLIC CONTRACTS ACT
- Clause does not apply to a contract performed in a foreign country, see 22.603.

(18) 52.217-7117
- EQUAL OPPORTUNITY CLAUSE
- Contract exempt from EO 11246 if work performed outside the U.S. by employees who were not recruited within the U.S., see 22.807(b)(2).

(22) 52.217-7121
- AUTHORIZATION AND CONSENT
- Clause does not apply in contract when both performance and delivery are outside U.S., see 27.201-2(a).

(23) 52.217-7122
- NOTICE AND ASSISTANCE REGARDING PATENT AND COPYRIGHT INFRINGEMENT
- Clause does not apply in contract when both performance and delivery are outside U.S., see 27.202-2.

(27) 52.217-7126
- AFFIRMATIVE ACTION FOR DISABLED VETERANS AND VETERANS OF THE VIETNAM ERA.
- Clause does not apply to employment openings filled outside the U.S., see 52.222-35(d) and 22.1308.

(28) 52.217-7127
- AFFIRMATIVE ACTION FOR HANDICAPPED WORKERS
- Clause does not apply to work performed outside the U.S., see 22.1408.

(29) 52.217-7128
- CLEAN AIR AND WATER
- Clause does not apply to work performed outside the U.S., see 23.101.

(33) 52.217-7132
- DEPARTMENT OF LABOR SAFETY AND HEALTH REGULATIONS FOR SHIP REPAIRING
- Clause applies only to work performed on the navigable waters of the U.S.

§ 17.7104(b) (1) 52.217-7200
- WORKMEN'S COMPENSATION AND WAR HAZARD INSURANCE OVERSEAS
- Clause applies only in a public-work contract performed outside the U.S. and the Secretary of Labor waives the applicability of the Defense Base Act, see 28.309(b).

(2) 52.217-7201
- BUY AMERICAN ACT AND THE BALANCE OF PAYMENTS PROGRAM
- Does not apply in contract for services which does not primarily involve the acquisition of equipment or supplies, see 25.109(d)(70) and 25.302(72)(1)(v).
- See also 25.7101 exemption of the restrictions of the Balance of Payments Program and the Buy American Act[for acquisition of supplies mined, produced, or manufactured in Canada].

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(10) 52.217-7209
- UTILIZATION OF SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS
- Clause does not apply when performance is outside the U.S., see 52.219-8 and 52.219-9.

(15) 52.217-7214
- UTILIZATION OF LABOR SURPLUS AREA CONCERNS
- Would not apply to Canadian contractor unless one or more of its subcontractors would perform within the U.S., see 20.302(a).

(17) 52.217-7216
- EQUAL OPPORTUNITY PRE-AWARD CLEARANCE OF SUBCONTRACTS
- Clause would not apply in contract performed outside U.S., see 22.807(b)(2).

(20) 52.217-7219
- FEDERAL, STATE, LOCAL, AND FOREIGN TAXES
- Clause does not apply unless contractor does business in U.S., see 52.229-8.

(22) 52.217-7221
- PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA
- Not required pursuant to Determinations and Findings, signed Everett Pyatt, dated 2 February 1985.

(31) 52.217-7230
- AUDIT BY DEPARTMENT OF DEFENSE
- Not required pursuant to 10 USC 2313.

(32) 52.217-7231
- SUBCONTRACTOR COST OR PRICING DATA
- Not required pursuant to Determinations and Findings, signed Everett Pyatt, dated 2 February 1985.

(38) 52.217-7237
- UTILIZATION OF WOMEN-OWNED BUSINESS CONCERNS
- Not required in contracts performed outside the U.S., see 19.902.

(44) 52.217-7243
- COST ACCOUNTING STANDARDS
- Not applicable to work in Canada, see 30.301(b)(4).

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[(49) 52.217-7248
-PREFERENCE FOR DOMESTIC SPECIALTY METALS
-See 52.225-7012(a)(ii).]

(51) 52.217-7250
- EXCLUSIONARY POLICIES AND PRACTICES OF FOREIGN GOVERNMENTS
- Applicable only to MAP, IMET and FMS contracts, see 25.7312.

(54) 52.217-7253
- QUALIFYING COUNTRY SOURCES AS SUBCONTRACTORS
- Not applicable except where service contracts primarily involve acquisition of equipment or supplies, see 25.109(d)(72), 25.109(d)(70), 25.302(72)(1)(v), 25.407(a)(2) and 25.403(f).

The above clauses would normally not be included by MSC in contracts for the repair of vessels to be performed entirely in Canada. For those job orders where the parties contemplate partial performance in the U.S., the above clauses would be included by the Contracting Officer as appropriate.

Sincerely,

Richard S. Haynes

RICHARD S. HAYNES
Counsel

GAO note: Material in brackets added by GAO at the request of MSC.

AGREEMENT ON PRINCIPLES FOR ECONOMIC

COOPERATION

CANADA

INDUSTRIAL MOBILIZATION

TIAS 2136
Oct. 26, 1950

Agreement effected by exchange of notes signed at Washington October 26, 1950; entered into force October 26, 1950.

The Secretary of State to the Canadian Ambassador

DEPARTMENT OF STATE
WASHINGTON
October 26, 1950

EXCELLENCY:

I have the honor to refer to recent discussions between representatives of our two Governments for the general purpose of reaching an agreement to the end that the economic efforts of the two countries be coordinated for the common defense and that the production and resources of both countries be used for the best combined results. Their deliberations were based on concepts of economic cooperation which were inherent in the Hyde Park Agreement of 1941 [1] and which are still valid today. They formulated and agreed to the "Statement of Principles for Economic Cooperation" annexed hereto, which is intended to guide, in the light of these basic concepts, the activities of our respective Governments.

If this attached statement is agreeable to your Government, this note and your reply to that effect will constitute an agreement between our two Governments on this subject.

Accept, Excellency, the renewed assurances of my highest consideration.

DEAN ACHESON

His Excellency
HUME WRONG,
Ambassador of Canada.

[1] *Department of State Bulletin*, Apr. 26, 1941, p. 494.

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Source: United States Treaties and Other International Agreements, Volume 1, 1950, Department of State

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STATEMENT OF PRINCIPLES FOR ECONOMIC COOPERATION

The United States and Canada have achieved a high degree of cooperation in the field of industrial mobilization during and since World War II through the operation of the principles embodied in the Hyde Park Agreement of 1941, through the extension of its concepts in the postwar period and more recently through the work of the Joint Industrial Mobilization Planning Committee. In the interests of mutual security and to assist both governments to discharge their obligations under the United Nations Charter and the North Atlantic Treaty, it is believed that this field of common action should be further extended. It is agreed, therefore, that our two governments shall cooperate in all respects practicable, and to the extent of their respective executive powers, to the end that the economic efforts of the two countries be coordinated for the common defense and that the production and resources of both countries be used for the best combined results.

59 Stat. 1031.
63 Stat., pt. 2, p. 2241.

The following principles are established for the purpose of facilitating these objectives:

1. In order to achieve an optimum production of goods essential for the common defense, the two countries shall develop a coordinated program of requirements, production, and procurement.

2. To this end, the two countries shall, as it becomes necessary, institute coordinated controls over the distribution of scarce raw materials and supplies.

3. Such United States and Canadian emergency controls shall be mutually consistent in their objectives, and shall be so designed and administered as to achieve comparable effects in each country. To the extent possible, there shall be consultation to this end prior to the institution of any system of controls in either country which affects the other.

4. In order to facilitate essential production, the technical knowledge and productive skills involved in such production within both countries shall, where feasible, be freely exchanged.

5. Barriers which impede the flow between Canada and the United States of goods essential for the common defense effort should be removed as far as possible.

6. The two governments, through their appropriate agencies, will consult concerning any financial or foreign exchange problems which may arise as a result of the implementation of this agreement.

The Canadian Ambassador to the Secretary of State

CANADIAN EMBASSY
AMBASSADE DU CANADA

WASHINGTON, D. C.,
October 26, 1950.

No. 619

SIR:

I have your note of today with regard to the recent discussions between representatives of our two Governments for the purpose of reaching an agreement to the end that the economic efforts of the two countries be coordinated for the common defence and that the production and resources of both countries be used for the best combined results. I am glad to confirm that the "Statement of Principles for Economic Cooperation", which was annexed to your note, is acceptable to my Government. Your note and this reply will, therefore, constitute an agreement between our two Governments on this subject.

Accept, Sir, the renewed assurances of my highest consideration.

H. H. WRONG

The Honourable DEAN ACHESON,
Secretary of State of the
United States of America,
Washington, D. C.

APPENDIX XIII

HYDE PARK AGREEMENT ON EXCHANGE OF DEFENSE ARTICLES

EXCHANGE OF DEFENSE ARTICLES

Joint statement issued at Hyde Park, N.Y., April 20, 1941, by President Franklin D. Roosevelt and Prime Minister W. L. Mackenzie King

Department of State Bulletin,
April 26, 1941, p. 494

Among other important matters, the President and the Prime Minister discussed measures by which the most prompt and effective utilization might be made of the productive facilities of North America for the purposes both of local and hemisphere defense and of the assistance which in addition to their own programs both Canada and the United States are rendering to Great Britain and the other democracies.

It was agreed as a general principle that in mobilizing the resources of this continent each country should provide the other with the defense articles which it is best able to produce, and, above all, produce quickly, and that production programs should be coordinated to this end.

While Canada has expanded its productive capacity manyfold since the beginning of the war, there are still numerous defense articles which it must obtain in the United States, and purchases of this character by Canada will be even greater in the coming year than in the past. On the other hand, there is existing and potential capacity in Canada for the speedy production of certain kinds of munitions, strategic materials, aluminum, and ships, which are urgently required by the United States for its own purposes.

While exact estimates cannot yet be made, it is hoped that during the next 12 months Canada can supply the United States with between $200,000,000 and $300,000,000 worth of such defense articles. This sum is a small fraction of the total defense program of the United States, but many of the articles to be provided are of vital importance. In addition, it is of great importance to the economic and financial relations between the two countries that payment by the United States for these supplies will materially assist Canada in meeting part of the cost of Canadian defense purchases in the United States.

Insofar as Canada's defense purchases in the United States consist of component parts to be used in equipment and munitions which Canada is producing for Great Britain, it was also agreed that Great Britain will obtain these parts under the Lend-Lease Act and forward them to Canada for inclusion in the finished article.

The technical and financial details will be worked out as soon as possible in accordance with the general principles which have been agreed upon between the President and the Prime Minister.

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Source: Treaties and Other International Agreements of the United States of America 1776-1949, Department of State (6 Bevans 216)

APPENDIX XIV

EXTRACT FROM THE SECOND REPORT OF THE

SPECIAL STUDY MISSION TO CANADA

[COMMITTEE PRINT]

85TH CONGRESS } HOUSE OF REPRESENTATIVES
2d Session }

SECOND REPORT

OF THE

SPECIAL STUDY MISSION TO CANADA

COMPRISING

HON. BROOKS HAYS, Arkansas

HON. FRANK M. COFFIN, Maine

OF THE

COMMITTEE ON FOREIGN AFFAIRS

PURSUANT TO

H. Res. 29

A RESOLUTION AUTHORIZING THE COMMITTEE ON FOREIGN AFFAIRS TO CONDUCT THOROUGH STUDIES AND INVESTIGATIONS OF ALL MATTERS COMING WITHIN THE JURISDICTION OF SUCH COMMITTEE

DECEMBER 19, 1958

Printed for the use of the Committee on Foreign Affairs

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1958

83954

APPENDIX XIV

IV. DEFENSE

There is exceedingly close cooperation between the United States and Canada in all defense matters. Continental Air Defense is under joint United States-Canadian command. A United States Air Force general is chief of the Air Defense Command and a Canadian is deputy. The operations are under joint control. Canada and the United States are joint partners in NATO undertakings and there is exceedingly close liaison between the two countries on every level of defense planning.

On April 20, 1941, President Roosevelt and Prime Minister Mackenzie King entered into the Hyde Park Agreement, under which agreement the United States and Canada agreed to cooperate on matters of defense procurement. The principle of cooperation enunciated in the 1941 agreement has continued down to the present. On October 26, 1950, the two Governments extended the Hyde Park Agreement by issuing a so-called statement of principles for economic cooperation whereby the two Governments agree to take joint action to stimulate defense production and to remove economic barriers impeding the common defense. There follows a tabulation of reciprocal military purchasing with Canada:

APPENDIX XIV

Reciprocal military purchasing with Canada

[In thousands]

Fiscal year	United States purchases in Canada [1]	Canadian purchases in the United States [2]
1951 ($100,000,000 objective for each country)	$46,000	[3] $247,849
1952 ($300,000,000 objective for each country)	224,874	258,070
1953 (no stated objective)	273,942	70,339
1954 (no stated objective)	27,503	117,928
1955 (no stated objective)	[3] 76,238	46,352
1956 (no stated objective)	[3] 26,513	25,766
1957 (no stated objective)	[3] 66,791	18,555
1958 (no stated objective)	[3] 34,630	39,791
Accumulation	776,491	[4] 825,950

[1] Data supplied by United States military establishments.
[2] Data supplied by Canadian Department of Defense Production.
[3] This differs substantially from earlier figures given for the 1st year of the arrangement; some purchases for fiscal year 1949-50, before the objective was set, have been added.
[4] This accumulation represents the gross value of contracts for procurement. There have been substantial reductions and terminations. At the end of June 1958, the net figure stood at $580,511,300; there is no comparable figure giving United States reductions and terminations.

Source: Office of the Assistant Secretary of Defense for International Security Affairs.

Despite the cooperation evidenced by the above figures there has been considerable dissatisfaction in Canada with defense procurement. This dissatisfaction was brought to a head last summer when the Canadian Government announced that it was terminating procurement action on the Arrow aircraft and substituting the United States-produced BOMARC antiaircraft missile. The Canadians had spent approximately $300 million in developing the Arrow and they had hoped that the United States would procure this supersonic aircraft either for United States forces or for the United States military assistance program. At the same time that the Arrow was under development, the United States had been developing a similar aircraft. It was found that there was no need in the United States military program for the Arrow. The Canadians, when faced with this prospect, realized that production of the Arrow would be uneconomical and that it might be better to concentrate on the next following generation of weapons. Among this generation is the BOMARC. Economic production of this weapon is beyond Canadian capacity.

Since the Canadians have become aware that they will have to look more and more to the United States for the production of the more exotic and more unusual weapons, such as supersonic aircraft and missiles, the question is being asked why there is not reciprocal action by the United States in procuring components and parts from Canada where there is a manufacturing capacity for this type of production. Although, as pointed out previously, there has been considerable procurement from Canada, the major portion has been in the form of goods and raw materials rather than in the form of manufactured end items or components. The Canadians would like to have a share of the manufactured end of defense procurement. The Canadians at present are able to bid on United States contracts. This ability, however, is sharply limited by the "Buy American" act and by the limited circulation which United States bid solicitations receive. Although a Canadian manufacturer may have the capacity necessary to bid on a contract, he may not be aware of the existence of the invitation to bid.

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We heard repeated comment on this situation while we were in Canada. It would appear to us that the executive branch of the United States Government should give some consideration to the establishment of some means whereby more information on defense procurement proposals could be made available at an earlier stage in Canada. The argument, of course, can be made that such contracts should be kept at home but if the Canadians are to buy huge quantities of very expensive missiles and other exotic weapons from us, it would appear to be sound policy to give them ample opportunity to compete on the component and small-item business. Accordingly, in our recommendations we are proposing the adoption of such a course.

APPENDIX XV

EXTRACTS FROM NATIONAL SECURITY COUNCIL

POLICY PAPER NSC 5822/1

P. 7

UNCLASSIFIED

NSC 5822/1

December 30, 1958

NATIONAL SECURITY COUNCIL

CERTAIN ASPECTS OF U. S. RELATIONS WITH CANADA

NSC 5822/1 rescinded per 1/12/62 memo

11/1/77

UNCLASSIFIED
SECRET

DECLASSIFIED
Auth: EO 11652
Date: 11/1/77
By: C. Dodson
NATIONAL SECURITY COUNCIL

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NSC 5822/1

December 30, 1958

NOTE BY THE EXECUTIVE SECRETARY
TO THE
NATIONAL SECURITY COUNCIL
ON
CERTAIN ASPECTS OF U. S. RELATIONS WITH CANADA

REFERENCES: A. Memo for NSC from Executive Secretary, subject: "U. S. Relations with Canada", dated July 16, 1958.
B. Memos (2) for NSC from Executive Secretary, subject: "Certain Aspects of U. S. Relations with Canada," dated December 22, 1958.
C. NSC Actions Nos. 1964 and 2025

The National Security Council, the Acting Secretary of the Treasury, the Attorney General, the Secretary of the Interior, the Secretary of Commerce, and the Director, Bureau of the Budget, at the 392nd NSC Meeting on December 23, 1958, adopted the statement of policy in NSC 5822, as amended by NSC Action No. 2025-b.

The President has this date approved the statement of policy in NSC 5822, as amended and adopted by the Council and enclosed herewith as NSC 5822/1. The President approved Section A as guidance from the standpoint of national security and directed that it be taken into account by the President's Special Committee to Investigate Crude Oil Imports and by other appropriate Executive Departments and Agencies of the U. S. Government. The President approved Sections B-D and directed their implementation by all appropriate Executive Departments and Agencies of the U. S. Government under the coordination of (1) the Secretary of Defense for Sections B and C, and (2) the Director, Office of Civil and Defense Mobilization for Section D.

JAMES S. LAY, JR.
Executive Secretary

cc: The Secretary of the Treasury
The Attorney General
The Secretary of the Interior
The Secretary of Commerce
The Director, Bureau of the Budget
The Chairman, Atomic Energy Commission
The Chairman, Joint Chiefs of Staff
The Director of Central Intelligence
The Chairman, Council on Foreign Economic Policy
The Chairman, Council of Economic Advisers

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CERTAIN ASPECTS OF U. S. RELATIONS WITH CANADA

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SECTION C. PARTICIPATION BY CANADIAN INDUSTRY IN PRODUCTION OF EQUIPMENT FOR THE DEFENSE OF THE NORTH AMERICAN CONTINENT

DISCUSSION

1. Efforts by the United States and Canada toward mutual cooperation in the broad area of defense production and procurement began in 1941 with the Hyde Park Agreement (Appendix 1). Pursuant to the Agreement, the United States, during World War II, bought materiel in Canada valued at approximately $1½ billion, which was about equal to the value of Canadian purchases in the United States. In May 1945, at the request of the United States, the principles of the above agreement were extended into the post-war period. Among the subsequent steps taken by the two countries to coordinate their economic efforts in the common defense were: (a) the establishment of a joint U. S.-Canada Industrial Mobilization Committee in 1949; (b) promulgation of the "Statement of Principles for Economic Cooperation" in 1950 (Appendix 2); and (c) agreement to a Reciprocal Military Purchasing Arrangement, also in 1950.

2. The above arrangements and agreements clearly indicate that both the United States and Canada have accepted cooperation in the defense production field as a matter of policy. An outstanding example of this cooperation is the program developed under the arrangement for reciprocal procurement of military equipment, which has as its objective to provide: (a) a greater standardization of military equipment; (b) a wider

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dispersal of hemispheric munitions production facilities; (c) a supplemental source of supply for the United States and other NATO countries; and (d) an increase of defense cooperation between the two countries. Through this program the United States has made approximately $775 million of defense purchases in Canada during the period FY's 1951-1958, with Canadian gross purchases in the United States totaling about $825 million for the same period (Appendix 3). The program has assisted considerably in bringing the two military establishments closer together.

3. The Canadians are appreciative of the broad lines of the policy of cooperation in defense production which Canada and the United States have followed since 1941, but are not satisfied with the present U. S. interpretation and implementation of this policy. In recent negotiations they have held that the provision in the agreements on joint installations in Canada (which provides that electronic equipment used in the joint installations should, as far as practicable, be manufactured in Canada) should be interpreted to mean that: (a) contracts should be awarded to Canadian firms if they can meet the specifications and a reasonable delivery date; (b) Canadian firms should not be directly competitive with U. S. bidders insofar as price is concerned; and (c) if the prices bid by Canadian firms are reasonable by Canadian standards, a lower bid by a U. S. manufacturer should not determine the award. The United States, on the other hand, has maintained that before Canadian firms can be accorded preference they should meet the

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prices quoted by U. S. bidders. With respect to implementation of the policy, the Canadians assert that at present too much emphasis is placed on determining whether individual items are to be manufactured in Canada or in the United States, and not enough on working toward genuine integration of the defense production and development capabilities of the two countries, with the objective of maintaining diversified defense industrial facilities in each.

4. In its desire to assist Canada's defense production industry, the Canadian Government is confronted with a dilemma. On the one hand, the Government has emphasized the rights of Canada as a sovereign power and the relationship of defense production to Canadian industrial and scientific growth; on the other hand, it is faced with the economic reality that Canada does not have the resources to finance the more expensive weapons systems for modern defense. The Government's difficulty is exemplified by its recent decision to reduce drastically the production of the Canadian-developed CF-105 supersonic interceptor aircraft and to introduce into the Canadian air defense system the U. S.-produced BOMARC missile in its stead. Development of the CF-105 has cost Canada $303 million, and completion of the development and procurement of the aircraft to meet Canada's requirement of approximately 100 aircraft would have cost $1¼ billion more. Before making this decision, Canadian officials tried unsuccessfully to interest the

United States in the purchase of CF-105 aircraft for use by the USAF, a proposal which was rejected on the grounds that the United States had under development aircraft of superior performance and earlier availability.

5. While the Canadian Government does not now contemplate an independent Canadian effort to develop a new weapons system for continental defense, it can be expected to be sensitive over any future defense production arrangements which create the impression that Canada will produce only minor components for joint defense projects in Canada while the United States produces all the important major components. That the Canadian Government intends to press for significant Canadian participation in such production was revealed in recent discussions concerning the proposal (a) to strengthen the PINETREE system with additional radars, (b) to extend the semi-automatic ground environment (SAGE) system into Canada, and (c) to introduce the BOMARC missile into the Canadian air defense system. In approving the proposal, subject to agreement on cost sharing, the Canadian Government made it clear that Canadian industry must be permitted to share in production related to these projects as well as to future joint defense projects. Furthermore, during the recent U. S.-Canadian conference on defense production, the Canadians stressed the need for early discussion of the sharing of defense production and expressed the hope that Canada could play a significant role in such

production "without becoming a subcontractor", and that Canada might also assist in research and development work.

6. It is evident that Canada's desire to participate in the production of equipment for continental defense is not being satisfied under the Reciprocal Military Purchasing Arrangement as presently implemented. While total U. S. purchases in Canada under this arrangement have been quite substantial--they amounted to more than $270 million in FY 1953--they have dwindled drastically in recent years. There are certain obstacles, however, to a substantial increase of U. S. defense purchases in Canada. Several segments of American industry would object strongly to giving Canadian concerns an equal opportunity to receive defense prime contracts, especially in view of significant pockets of unemployment in the United States, and would probably cite the "Buy American" Act as a basis for their objections. (This Act applies to purchases of supplies and equipment for public use in the United States but not to those for use outside the United States. With respect to purchases of certain Canadian-produced items for use in the United States, the Military Departments have taken advantage of an exception to the law which permits each Department to determine that it would be inconsistent with the public interest to apply the restrictions of the Act.) Another obstacle is the attitude of the Canadians, who have often insisted on producing equipment that is readily available from an active production line in the United States and on occasion have maintained that Canadian firms should not be directly competitive with U. S.

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bidders insofar as price is concerned. There are also other obstacles, including those connected with security, programming, patent and royalty rights, and proprietary rights.

7. Overcoming the above obstacles will not require a change in the policy set forth in the "Statement of Principles of Economic Cooperation". As the Canadians themselves recently pointed out, the two governments in approving these Principles agreed to cooperate "in all respects practicable, and to the extent of their respective executive powers, to the end that the economic efforts of the two countries be coordinated for the common defense and that the production and resources of both countries be used for the best combined results". Moreover, the Principles include the statement that "the two countries shall develop a coordinated program of requirements, production, and procurement". Thus, what appears to be necessary is the development and implementation of improved procedures for carrying out these Principles. Such procedures, however, should not accord Canadian firms a preferred position in bidding for defense contracts, inasmuch as preferential treatment to Canadian firms probably would result in a less economical use of defense funds and provoke criticism by the affected segments of U. S. industry and labor.

8. While Canada is not economically capable of independently developing and producing the large complex weapons and weapons systems required under modern defense concepts,

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Canadian firms are capable of producing major components of these weapons and weapons systems. They are also capable of independently producing defense equipment of a less complex nature, including trainer, transport, and reconnaissance aircraft and certain types of radar and communications equipment. However, Canada's individual defense requirements are not sufficient to support Canada's extensive and diversified production base, and Canadian defense industries are not likely to thrive unless they are able to share in the production of weapons and defense systems now under development by the United States or some other NATO power. Unless Canadian defense industries do remain healthy, the United States probably will not receive the same excellent cooperation in the joint defense effort that has prevailed in the past. Moreover, the United States would lose the reserve potential of scientific knowledge, technical capability and industrial capacity developed within Canadian defense industries.

POLICY GUIDANCE

9. Take steps, as feasible, to assure Canada a fair opportunity to share in the production of military equipment and materiel involving programs of mutual interest to Canada and the United States, and in the research and development connected therewith. Such steps, to the extent practicable, should include measures to: (a) promote closer integration of U. S. and Canadian military

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production; (b) provide for the necessary flow of information to Canadian firms; (c) insure the most economical use of defense funds; and (d) accord equal consideration to the business communities of both countries.

APPENDIX 3

RECIPROCAL MILITARY PURCHASING WITH CANADA

	U. S. Purchases in Canada 1/	Canadian Purchases in U. S. 2/
	(Thousands of Dollars)	
FY 1951 ($100 million objective for each country)	$ 46,000	$247,839 3/
FY 1952 ($300 million objective for each country)	224,874	258,970
FY 1953 (no stated objective)	273,942	70,339
FY 1954 (no stated objective)	27,503	117,928
FY 1955 (no stated objective)	76,238 2/	46,352
FY 1956 (no stated objective)	26,513 2/	25,766
FY 1957 (no stated objective)	66,791 2/	18,555
FY 1958 (no stated objective)	34,630 2/	39,791
Accumulation	$776,491	$825,540 4/

1/ Data supplied by U. S. military establishments.

2/ Data supplied by Canadian Department of Defense Production.

3/ This differs substantially from earlier figures given for the first year of the arrangement; some purchases for FY 1949-50, before the objective was set, have been added.

4/ This accumulation represents the gross value of contracts for procurement. There have been substantial reductions and terminations. At the end of June 1958, the net figure stood at $580,511,300; there is no comparable figure giving U. S. reductions and terminations.

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