



B-175633

NOV 3 1975

The Honorable Gerry E. Studds
House of Representatives

Dear Mr. Studds:

Your letter of May 15, 1975, on behalf of Bristol Electronics, Inc., New Bedford, Massachusetts, requested that we determine the validity of certain allegations against two firms supplying AN/PRC-77 radio sets under Army contracts awarded under invitation for bids No. DAAB05-72-B-0012. The firms involved are the Cincinnati Electronics Corporation, Cincinnati, Ohio, and Sentinel Electronics, Incorporated, Philadelphia, Pennsylvania.

We discussed the contracts with officials at the Army Materiel Command Headquarters, Alexandria, Virginia, and reviewed contract files and interviewed cognizant personnel at the Army Electronics Command, Fort Monmouth, New Jersey. We also discussed the Cincinnati contract with the administrative contracting officer, Defense Contract Administration Services District, Cincinnati.

BACKGROUND

The AN/PRC-77 is a portable, short-range radio set originally developed and initially manufactured by the Radio Corporation of America. The radio was later produced by various other manufacturers prior to the Army Electronics Command's award of fixed-price contracts to Cincinnati and Sentinel in June 1973.

The invitation for bids contained a Buy American Act clause, and both contractors certified that the radios to be delivered under their contracts would be domestic source end products in compliance with the act's implementing regulatory requirements.

Cincinnati's contract required the first delivery of production radios in January 1975; Sentinel's contract required first delivery in February 1975. Both contracts scheduled delivery of about 16,650 radios over a 27-month period and included an option for the Army to increase the quantity. Both Cincinnati and Sentinel priced the scheduled requirements at approximately \$431 per unit.

PSAD-76-41

EVALUATION OF ALLEGATIONS

Each of the allegations cited in your letter is restated below and is followed by our evaluation.

1. Both Cincinnati and Sentinel are assembling all or part of these radio sets in Mexico and Israel in possible violation of the Buy American Act of 1933.

Essentially, the Buy American Act requires that only domestic source end products shall be acquired for public use. The act, as implemented by the Armed Services Procurement Regulation (ASPR), provides that an end product is to be considered a domestic source end product (1) if it is manufactured in the United States and (2) if the cost of its components which are manufactured in the United States exceeds 50 percent of the total cost of all its components. Components are defined as those articles, materials, and supplies which are directly incorporated into the end product delivered to the Government.

We have previously examined the question of Sentinel's compliance with the Buy American Act in connection with its originally planned procurement arrangement with Tadiran, Israel Electronics Industries, Ltd. We concluded in our decision to the Secretary of the Army in 52 Comp. Gen. 886, May 31, 1973, that this arrangement, wherein Tadiran would function as a component purchasing agent for Sentinel, did not constitute a violation of the act since the majority of the components would be of domestic origin and the end product radio would be assembled by Sentinel in the United States.

We learned, however, in the course of our current review, that Sentinel now intends to purchase components directly from United States firms rather than through Tadiran. The Army Electronics Command has, accordingly, requested the Government's quality assurance representative at Sentinel's plant to review all purchase orders prior to release and to identify any orders that are for foreign firms. We believe the controls established are adequate to assure Buy American Act compliance under Sentinel's direct procurement plan.

Cincinnati has taken a different approach to the production of radios under its contract. Components are purchased by Cincinnati's Ohio plant, inspected there, and shipped to a wholly owned subsidiary (CE Sonora) in Hermosillo, Sonora, Mexico, for assembly. The Sonora plant ships back a nearly fully assembled radio for final assembly, testing, conditioning, and adjusting at the Ohio plant.

B-175633

The Defense Contract Administration Services District in Cincinnati, Ohio, inspects all components before they are shipped to the Sonora plant. The District administrative contracting officer stated that virtually all are of domestic origin.

Although we believe the monitoring system established is adequate to assure that the level of foreign-made components supplied to Sonora does not exceed the limit prescribed by the Buy American Act, we have reservations as to whether the manufacturing effort conducted by Cincinnati's Ohio plant is in keeping with the intent of the act's other provision, which requires that the end product be "manufactured in the United States."

Documents in the Army Electronics Command's contract files indicated that Sonora assembles an essentially complete radio and that only 10 to 15 percent of the total assembly man-hours are performed at the Ohio Plant.

The Army has taken the position that, if the final manufacturing process takes place in the United States, the end product is "manufactured in the United States." Thus, since the completing or final assembly operation is performed at the Ohio plant, even though it amounts to only 10 to 15 percent of the total assembly work, the Army believes that Cincinnati is in compliance.

It is reasonably clear under the act that, if all assembly operations were performed at the Ohio plant, the end product would qualify as being "manufactured in the United States," and that, if all assembly operations were performed at Sonora, the end product would not qualify.

The Buy American Act and ASPR, however, are silent with respect to situations such as Cincinnati's where the manufacture of an item is split between foreign and domestic locations and, though we have reservations, as stated above, we are not prepared to say that Cincinnati has violated the Buy American Act. We discussed both the Buy American Act issue and our conclusions with a knowledgeable official in the Office of the Assistant Secretary of Defense who told us he believed the Army's position was in accordance with the intent of the act. He also told us that, although questions regarding interpretation of the requirement that end products be "manufactured in the United States" have arisen before, they had not occurred with sufficient frequency to lead the ASPR Committee to consider amending the Regulation.

We believe that the infrequency of questions regarding interpretation of the requirement that end products be "manufactured in the United States" provides little assurance that the requirement is being either appropriately questioned or properly interpreted. Accordingly, we recommend that the Secretary of Defense amend ASPR to define and clarify the requirement that items acquired for public use be "manufactured in the United States."

2. Both Cincinnati and Sentinel are behind schedule on production.

The allegation is correct in the sense that neither Cincinnati nor Sentinel met the original delivery schedules. The Army Electronics Command, however, has issued modifications to both contracts revising the delivery requirements. At the time of our review, the modified contracts required first production delivery from Cincinnati in August 1975 (a 7-month slip) and from Sentinel in December 1975 (a 10-month slip).

The Army acknowledged that 3 months of the delay on both contracts was attributable to deficiencies in the technical data package furnished to the contractors by the Electronics Command.

Cincinnati and the Electronics Command negotiated an agreement in March 1975 that the 4-month balance of the 7-month slip on the Cincinnati contract would be incorporated at no change in contract price and that both the contractor and the Army would withdraw prior claims for monetary consideration on certain other matters.

At the completion of our review, Sentinel and the Electronics Command had not agreed on the causes for the 7-month balance of the 10-month slip on the Sentinel contract and both parties had reserved their rights. The modification revising the delivery schedule states the parties are not in agreement that the delay is excusable and that both agree that the contract modification shall in no way waive, prejudice, or alter the rights and remedies of either.

3. Both Cincinnati and Sentinel have applied for emergency financial aid which, if approved, will mean an increased cost per unit on the original contracts.

B-175633

The allegation is correct. Both contractors have requested financial relief under the provisions of Public Law 85-804 and, if the requests are granted, the unit price of radios on both contracts would be increased substantially.

The implementing regulations of Public Law 85-804 permit an increase in contract price when necessary to prevent a loss under a contract which would impair the productive ability of a contractor whose continued operation is essential to national defense.

Cincinnati's request, which was submitted in February 1975, sought relief in the amount of \$2.256 million for the full term of the contract. This would amount to a unit price increase of approximately \$136 (about 32 percent) on the Cincinnati contract.

Sentinel's request, which was submitted in April 1975, sought relief in the amount of \$1.708 million for radios scheduled for delivery in the first year of production. This would amount to a unit price increase of approximately \$258 (about 60 percent) for first year quantities on the Sentinel contract. Sentinel also requested 100 percent progress payments for first year quantities. In addition, Sentinel requested that the contract prices for the second and third year quantities be adjusted upward for inflation, using the increased first year price as a base.

Sentinel asked that the contract be terminated for the convenience of the Government if the requested relief was not granted.

The contractors' requests for financial relief and matters related to those requests are further discussed in the enclosure.

At the completion of our review, the Army had not made a decision on either contractor's request for financial relief. If the Army Electronics Command recommends approval, that recommendation would then be submitted to the Army Contract Adjustment Board, Washington, D.C., for final approval.

- - - -

It is our understanding, based on discussion with your office in early August, that you will provide Senator Edward M. Kennedy with copies of this report.

As you know, Section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to

B-175633

the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We will be in touch with your office in the near future to arrange for copies of this report to be sent to the Secretary of Defense and the four Committees to set in motion the requirements of Section 236.

Sincerely yours,

R. F. Kellum
Deputy Comptroller General
of the United States

Enclosure

ENCLOSURE

ENCLOSURE

DISCUSSION OF CONTRACTORS'
REQUESTS FOR FINANCIAL RELIEF
AND RELATED MATTERS

Under the implementing provisions of Public Law 85-804 contained in the Armed Services Procurement Regulation, both contractors maintained that their continued performance on various Government contracts was essential to national defense and that relief was necessary in order to prevent losses under the AN/PRC-77 contracts which would impair their continued operations. Sentinel stated that it would be forced into bankruptcy if the Government failed to grant relief or to terminate the contract for the convenience of the Government.

Sentinel maintained that the major portion of the expected loss under its contract resulted from a substantial increase in the cost of material. The contractor stated that its material cost estimates were developed when Phase II of the Government's wage and price control program was in effect and that, when the controls were later lifted, its material costs rose significantly.

Although the Sentinel and Cincinnati contracts both contained a price escalation clause, it was applicable only to labor cost increases after the first year of production deliveries.

Sentinel claimed that it and the Army Electronics Command were parties to a mutual mistake, as to a material fact, in failing to anticipate the escalation of prices after the elimination of wage and price controls. Electronics Command personnel advised us that Sentinel was in the process of revising its request for relief, but no specific information was available at the completion of our review.

Cincinnati claimed that the expected loss under its contract was a direct result of the Government's actions in awarding Cincinnati only half of the total procurement. The actions cited in Cincinnati's request for relief were those of the Small Business Administration and the Electronics Command's contracting officer, leading to the award of the set-aside portion of the invitation for bids to Sentinel and the non-set-aside portion to Cincinnati.

Cincinnati stated that in the development of its bid it had distributed costs over the total procurement quantity of about 33,300 radios on the assumption that it would receive an award for the total quantity and that it was unable to fully recover those costs under the contract it actually received for only 16,648 radios.

ENCLOSURE

ENCLOSURE

In connection with the matter of a split award, a Sentinel protest to us in late 1972 challenged Cincinnati's small business eligibility, and a Bristol Electronics protest in early 1973 challenged Sentinel's. We concluded in our decision to the Secretary of the Army in 52 Comp. Gen. 886, May 31, 1973, that, for the purpose of this procurement, Cincinnati did not qualify as a small business concern as required for the set-aside portion (one-half) of the invitation for bids. We found no merit, however, in Bristol's contention that Sentinel was not qualified as a small business concern because of improper affiliation or contractual arrangements with a large foreign firm. The set-aside portion of the procurement was subsequently awarded to Sentinel.

Cincinnati filed a protest with us against the award to Sentinel and, in June 1973, brought suit in the United States District Court for the Southern District of Ohio against the Secretary of the Army and the Administrator, Small Business Administration. Although Cincinnati had taken a different approach with the court than it did with us, the issues raised in the protest were so intertwined with those raised in the suit before the court that we declined consideration of the protest.

The District Court ruled against Cincinnati and, in August 1973, Cincinnati filed an appeal with the United States Court of Appeals for the Sixth Circuit. We were advised by a representative of the Army Electronics Command's Office of Chief Counsel that the Court of Appeals found that the contracting officer should have (1) forwarded Cincinnati's protest of Sentinel's business size to the Small Business Administration and (2) withheld the award of the set-aside contract to Sentinel pending a determination by the Administration.

In January 1975, the Court of Appeals declared that the contracting officer's failure to observe the above procedure was improper, but it denied Cincinnati's request that the Army be restrained from continuing the contract with Sentinel. We were further advised by the Electronics Command representative that the matter had been referred back to the District Court for further proceedings and that it had not been finally settled.