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REPORT TO THE SUBCOMMITTEE ON
PRIORITIES AND ECONOMY
IN GOVERNMENT ~~24-0308~~
JOINT ECONOMIC COMMITTEE



LM096044

Review Of Selected Subcontracts
Awarded by Ingalls Shipbuilding
Division Of Litton Industries, Inc.

B-177748

Department Of The Navy

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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

B-177748

The Honorable William Proxmire
Chairman, Subcommittee on Priorities
and Economy in Government
Joint Economic Committee
Congress of the United States

Dear Mr. Chairman:

Pursuant to your January 2, 1973, request we inquired into allegations that certain officials and employees of Ingalls Shipbuilding Division, Litton Industries, Inc., engaged in illegal or improper activities, including taking fees or kickbacks from subcontractors.

As agreed with your office, the scope of this review is limited to procurements from five Ingalls subcontractors where there were allegations that sound procurement practices were not followed. Our review was limited to an examination of the cases included in the four appendixes. We did not evaluate Ingalls' overall procurement system. Appendixes I through IV contain details on the transactions reviewed. The specific authority for our performing such reviews is set forth in the Anti-kickback Act (41 U.S.C. 51 et seq.)

The factual data we obtained did not reveal that payments of fees or kickbacks were made to Ingalls' officials or employees. The facts related to these procurements show that sound procurement practices were not followed.

Appendix I deals with purchases of lumber products by Ingalls from two subcontractors. In these instances, Ingalls' records indicated that preaward activities may have been conducted in a manner that insured awards to certain subcontractors. One contract was awarded to other than the lowest bidder, although the low bidder appeared to meet the procurement requirements. The records of this successful subcontractor show that \$75,000 was paid in commissions for Ingalls' business. Of this amount, \$40,000 was paid to another subcontractor who had also bid on the contract. The remaining \$35,000 was paid to an "agent" of the subcontractor. During

this review, the payment of \$40,000 was returned to Ingalls and we were advised that appropriate adjustments would be made to the applicable Government contracts.

The other successful subcontractor did not become the low bidder until the third resolicitation for bids. This solicitation increased the scope of the work, causing the other three responsive bidders to increase their bids while the successful bidder submitted a decreased price. After the award, the contract was changed to eliminate the requirements that increased the scope of work under the third resolicitation.

Appendix II describes a situation where two Ingalls quality assurance employees established a corporation supplying X-ray inspection services. These employees requested, received, and certified the receipt of services provided to Ingalls by the firm they had established. One of these employees was discharged. The other is still employed and denies any wrongdoing.

Appendix III concerns a \$6.4 million subcontract awarded to a small firm to provide waste heat boilers to Ingalls for Navy ships. Ingalls' records show that the successful bidder's proposal did not receive as extensive a review as a competitor's, and there was some question as to the acceptability of the subcontractor's business operations including such areas as quality assurance and safety. Shortly after award, the two Ingalls employees who participated in the negotiation of the award became president and vice president of that firm. There is information which shows that an official of the small firm offered a \$5,000 loan to one of these two employees after terminating his employment at Ingalls.

Appendix IV describes a situation where Ingalls' procurement officials knew a subcontractor was experiencing financial problems, yet they continued to award 22 additional subcontracts to this firm. The firm is now bankrupt. Ingalls is now providing the necessary financial support to this firm so that it can complete the subcontracts.

Most of the awards identified in the four appendixes were made before July 1972. Since then, Ingalls has removed or accepted resignations from seven of its employees involved in questionable procurement activities and has reorganized and consolidated its procurement functions. The President of Ingalls told us that he recognized the need for, and planned to implement, a procurement system change that would require any deviation from established normal procurement practice to be reported to a special group outside the normal procurement chain of command.

As your office requested, this report has not been made available to any agency, firm, or individual for comment, including those it might adversely affect. We plan no further distribution of this report because of the sensitive matters discussed and the lack of comments from the individuals, firms, or agencies concerned.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James B. Argets". The signature is written in a cursive style with a large initial "J".

Comptroller General
of the United States

LUMBER PRODUCTS PURCHASED FROM
NIEDERMEYER-MARTIN COMPANY AND
MIRON BUILDING PRODUCTS COMPANY

In December 1971 Ingalls awarded one subcontract to the Niedermeyer-Martin Company, and two subcontracts in April 1972 to Miron Building Products Company, Inc., for lumber products. The Niedermeyer subcontract was for scaffold boards, and the Miron subcontracts were for blocks and wedges.

PREAWARD ACTIVITIES OF CERTAIN
OPERATIONS PERSONNEL

Three ex-Ingalls operations personnel involved in pre-award activities concerning the Niedermeyer and Miron subcontracts were:

1. N. Milakovich, Vice President, Operations.
2. G. Starling, Manager, Modular Translation, Heavy Lifts and Rigging.
3. A. Gelsomino, Section Manager, Project Tool Design and Planning, Advanced Methods and Manufacturing Technology.

These three terminated their employment with Ingalls in 1972.

The factual data we obtained on the Niedermeyer and Miron subcontracts does not show that these three men or any other Ingalls employees received kickbacks related to these awards. However, the facts do show that sound procurement practices were not followed in the preaward activities associated with these subcontracts.

The following sections of this appendix contain the factual data gained during our examination.

Award to Niedermeyer

On August 30, 1971, Ingalls requested bids for scaffold boards from seven potential suppliers, including Niedermeyer

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and Miron. After review and evaluation of the bids, Ingalls' procurement personnel (as distinguished from operations personnel) recommended award to the low bidder which was neither Niedermeyer nor Miron. Operations personnel did not concur with this recommendation and recommended that the scaffold boards be purchased from Niedermeyer. A subcontract was awarded to Niedermeyer for about \$118,000 more than the low bidder offered.

The reasons Ingalls offered in support of this recommendation for award to Niedermeyer and our comments on these reasons are discussed below.

1. "Niedermeyer is the only company that has a tried and proven method of producing scaffold boards that meets Ingalls' requirements."

Ingalls' records show that other companies also had methods that produced scaffold boards meeting its requirements. For example:

--On October 19, 1971, 2 months before the subcontract was awarded to Niedermeyer, Ingalls tested a scaffold board submitted by the low bidder and found that the board met its requirements.

--On October 25, 1971, Ingalls' officials reported that a scaffold board submitted by another bidder offering a lower price than Niedermeyer also had been examined and found acceptable.

2. "Niedermeyer will produce the best quality and safest boards."

The quality of the scaffold boards desired by Ingalls was specified in the initial requirements by reference to established industry quality standards. Niedermeyer, Miron, and two other bidders, including the low bidder, proposed to buy lumber from the same source.

An Ingalls safety engineer, after evaluating the manufacturing process to be used by the low bidder, concurred in a recommendation to award the subcontract to this firm.

3. "The four to six year life expectancy of Niedermeyer boards will provide greater cost effectiveness."

We were unable to find evidence in Ingalls' files to support the contention that the life expectancy of Niedermeyer's boards was greater than that offered by the low bidder. As noted above, the low bidder anticipated buying lumber from the same source as Niedermeyer and an Ingalls safety engineer and other Ingalls officials had examined and approved the low bidder's manufacturing processes.

Awards to Miron

On September 10, 1971, Ingalls requested bids for blocks and wedges required for commercial and Navy work from 11 potential suppliers, including Niedermeyer and Miron. After review and evaluation of the six bids received, Ingalls' procurement personnel recommended that separate awards be made to the lowest bidder on each item. This recommendation was not accepted. Instead, on November 22, 1971, Mr. Starling proposed, and Mr. Milakovich approved, changes to the specifications that required the successful subcontractor to establish a facility near the shipyard and supply blocks and wedges to Ingalls, at the prices offered, on an as-needed basis. This change also required that all lumber be treated with fire-retardant chemicals.

Mr. Gelsomino had also recommended these changes following an early November visit to potential vendors for scaffold boards. In his trip report, concurred in by Mr. Starling who also made the trip, he recommended that Ingalls negotiate with " * * * a financially responsible company, such as Miron * * *" for its total lumber requirements and have this firm maintain the necessary inventories in the Pascagoula, Mississippi, area and ship to Ingalls on a demand basis.

On December 6, 1971, new proposals were requested. On December 27, 1971, sealed bids were opened. Three of the four responsive firms increased their bids. Niedermeyer decreased its bid. Of the three bidders increasing their bids, Miron's increase was the least at \$20,000. Bidder 3's increase was \$117,000 and bidder 2, the only local bidder, increased its bid \$92,000. Following negotiations, procurement

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personnel recommended that the subcontracts be awarded to bidder 2, the bidder who offered the lowest price.

Mr. Gelsomino, after receiving this recommendation, reversed his position and notified Ingalls' procurement personnel that the blocks and wedges need not be treated with fire-retardant chemicals. On January 21, 1972, a third request for quotation was made. All four bidders responding offered lower prices.

Ingalls' cost analyst examined the bids and recommended that award be made to bidder 3, the low bidder. This recommendation was not accepted because Messrs. Gelsomino and Starling noted a possible ambiguity in the specification. Revised specifications explaining the increased scope of work were prepared, and a fourth set of bids was requested. Miron decreased its price and was now low bidder. The three other bidders had increased their prices.

Ingalls' procurement personnel requested "best and final offers" from the bidders. Miron remained low overall bidder, though it did not offer the lowest price for every item.

As required by the Navy contracts, the proposed subcontract was submitted to Navy for consent because the amount exceeded \$100,000. A Navy representative pointed out that \$8,000 could be saved if the award were split among the bidders. Miron, when notified that it was low on all but one item, reconsidered its price on that item and reduced the price by \$8,000 on the Navy blocks and wedges and \$6,000 on the commercial bid. Two subcontracts, one for Navy requirements and one for commercial requirements, were awarded to Miron on April 26, 1972.

After award to Miron, the following requirements, which Mr. Starling had added, were deleted.

- Inventory facilities to be established in Pascagoula area.
- Inventory level to be determined by the Manager of Rigging and Heavy Lifts and the Methods Engineering Department.

- Supplier to cut, store, and deliver wedges, as required.
- Supplier to retrieve nontreated lumber from shipyard, treat with fire-retardant chemicals, store at suppliers' site, and deliver to shipyard as required.
- Lumber retrieved from shipyard to be cut and delivered on demand.

Ingalls obtained price adjustments for deleting the first three requirements. However, at the time of our review in June 1973, Ingalls had not received a price adjustment for deleting the requirement that Miron retrieve lumber from the shipyard. We called this matter to the attention of Ingalls' procurement officials, and the subcontract price was reduced by \$9,300.

UNUSUAL TRANSACTIONS AND RELATIONSHIPS

There were a number of unusual transactions and relationships between Niedermeyer and Miron.

Niedermeyer was asked not to bid

Miron based its offers for all three Ingalls subcontracts on having a wholly owned Niedermeyer subsidiary manufacture, treat, and fabricate the lumber products. According to Niedermeyer officials, Miron asked that they not bid directly for Ingalls' business. Niedermeyer officials told us they refused Miron's request because, by bidding both directly and indirectly as a Miron supplier, they had two chances to obtain Ingalls' business.

Although Miron used the Niedermeyer subsidiary as its source of supply for blocks and wedges, Miron's bid for these subcontracts was lower than Niedermeyer's. Niedermeyer's bid for scaffold boards, however, was lower than Miron's; Niedermeyer therefore received the subcontract for scaffold boards. The scaffold boards were also manufactured by Niedermeyer's wholly owned subsidiary.

Niedermeyer payment to Miron

Niedermeyer's records show that it paid Miron, its competitor, \$40,000 which was classified as commission on

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Ingalls' business. Niedermeyer officials explained this payment as follows.

- On February 13, 1973, Niedermeyer purchased 200,000 board feet of lumber from Island Dock Lumber, Inc., for \$40,000. It sold this lumber to Miron on the same day for the same amount. Miron and Island Dock are owned by the same people.
- On March 2, 1973, Niedermeyer paid Island Dock \$40,000 for the lumber it purchased on February 13, 1973. Miron did not pay Niedermeyer for its lumber purchase. Instead, Niedermeyer liquidated the amount due from Miron by charging the \$40,000 to commissions on Ingalls' business and crediting Miron's account.
- Niedermeyer gave Miron the \$40,000 credit because, among other reasons, Ingalls' future lumber procurements were in the millions of dollars and it believed it would be advantageous to be friendly with Miron which had a facility in the Pascagoula area.

Contrary to Niedermeyer's explanations, a Miron official acknowledged receipt of the \$40,000 payment from Niedermeyer to Island Dock but stated that the payment was erroneous because Island Dock had not shipped any lumber to Niedermeyer. This official told us that Miron had not received any commission on Ingalls' business from Niedermeyer.

On August 23, 1973, Niedermeyer advised us that it had recently received payment of \$40,000 from Island Dock. Niedermeyer further advised us that, because the money did not belong to Niedermeyer, it was sending it to Litton. Litton officials advised us that they were sending the \$40,000 to Ingalls and that appropriate adjustments would be made to the applicable Government contracts.

Niedermeyer payments to Mr. Benton

In addition to payments it made to Miron, Niedermeyer paid a Mr. M. L. Benton about \$35,000, which it also classified as commissions on Ingalls' business.

Niedermeyer officials explained the payments to Mr. Benton as follows.

- In about March 1971 they were contacted by Mr. Benton who asked if he could be paid a commission on business he could obtain for them.
- They agreed to pay Mr. Benton a commission but did not prepare a written agreement.
- Mr. Benton then alerted them to Ingalls' proposed procurement of scaffold boards.
- They said that Niedermeyer had not been successful in bidding on prior Ingalls awards.
- They said that in December 1971 they received the order for scaffold boards.
- They set up a commission account and paid Mr. Benton about 5 percent of the subcontract value.
- They do not know what Mr. Benton did for them to get the order.

Mr. Benton, in response to our questions regarding his relationship to Niedermeyer and Ingalls, told us that:

- The agreement with Niedermeyer gave him exclusive rights as Niedermeyer's agent in Louisiana, Alabama, and Mississippi and entitled him to a 5-percent commission on any Niedermeyer sales made in this territory.
- The payments made by Niedermeyer were about 5 percent of the subcontract value.
- He played no role at the shipyard in insuring that Niedermeyer received the award.
- Although he recognized, from an employee list we showed him, some of the names of the Ingalls personnel involved in the award to Niedermeyer, he said none of the persons were close acquaintances.
- He paid no kickbacks to any Ingalls employee in consideration for the award.

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With Mr. Benton's permission, we examined his records and found that he had made 90 long distance calls to 2 Ingalls employees. These two were employees in Ingalls Advance Methods and Manufacturing Technology, the group responsible for requisitioning the scaffold boards, testing scaffold board samples, and preparing the rationale for awarding the scaffold board subcontract to Niedermeyer. The name of one employee, Mr. S. J. Brown, was included on a list we had shown Mr. Benton, but it was not one of the names Mr. Benton said he recognized. However, Mr. Brown told us that he, Mr. Benton, and another man had been partners in a restaurant and bar in Pascagoula.

In addition to Mr. Brown, two other Ingalls employees told us that they knew Mr. Benton. However, all three denied knowledge of Mr. Benton's relationship with Niedermeyer. They all denied receiving any kickback or payment from Mr. Benton, or anyone else, in connection with the scaffold board subcontract or any other subcontract.

X-RAY INSPECTION SERVICES PURCHASED FROM

GULF COAST INSPECTION AND TESTING, INC.

Ingalls awarded two subcontracts to a firm on February 4, 1970, and January 7, 1971. This firm was subsequently incorporated as Gulf Coast Inspection and Testing, Inc. Two of the incorporators of this firm were also quality assurance employees at Ingalls. From March 1970 through August 1971, Gulf Coast was paid about \$43,000 for X-ray services which these two Ingalls employees requested, received, and certified. Records of the State of Mississippi and at Ingalls showed that:

- Gulf Coast was first organized in 1963.
- Two Ingalls quality assurance employees were identified as directors and incorporators in Gulf Coast's articles of incorporation dated January 20, 1971.
- These employees requisitioned, received, and certified the receipt of services supplied by Gulf Coast.
- Ingalls learned of one employee's ownership interest in Gulf Coast in August 1970, yet it awarded Gulf Coast another subcontract on January 7, 1971.
- Ingalls terminated business relations with Gulf Coast on June 29, 1971.
- Ingalls directed that the firm be removed from its list of qualified bidders.
- One of the two employees was discharged in October 1971, but the other employee is still employed. The employee who was not removed maintains that, even though he aided in setting up Gulf Coast, he did not participate in the operation or management of the firm.

CORPORATE RECORDS

We obtained copies of the certificate of incorporation, dated January 20, 1971, and the articles of incorporation for Gulf Coast from the Office of the Mississippi Secretary of State. The articles of incorporation listed the four directors as:

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"W. N. INABINETTE, Route 2, Box 237, Ocean Springs, Mississippi

MARJORIE M. INABINETTE, Route 2, Box 237, Ocean Springs, Mississippi

P. SCORDINO, 4312 Magnolia Street, Pascagoula, Mississippi

MERCEDES SCORDINO, 4312 Magnolia Street, Pascagoula, Mississippi."

The articles also identified Mr. Inabinette and Mr. Scordino as Gulf Coast's incorporators.

By letter dated November 1, 1972, Mississippi's Secretary of State notified Mr. Inabinette that the rights conferred by the certificate and articles of incorporation were suspended because Gulf Coast failed to file its annual report and pay fees due.

Although the date of incorporation was January 20, 1971, Gulf Coast had existed since 1963.

EMPLOYMENT RECORDS

The following excerpts from employment records show that between March 1970 and August 1971--the period during which X-ray services were purchased from Gulf Coast for Ingalls' Quality Assurance Department--Messrs. Inabinette and Scordino were Ingalls' quality assurance employees.

<u>From</u>	<u>To</u>	<u>Position</u>
<u>W. N. Inabinette</u>		
3-11-63	6-24-70	Radiographic Supervisor
6-24-70	9-10-71	Section Manager, Industrial Laboratory
9-10-71	10-20-71	Senior Quality Engineer
10-20-71		Discharged
<u>P. Scordino</u>		
1- 6-69	8-23-71	Director, Quality Assurance
8-23-71	3-16-72	Director, Quality Control
3-16-72	7-14-72	Department Manager
7-14-72	3- 5-73	Director, Inspection Control
3- 5-73	Present	Manager, Engineering

PROCUREMENT RECORDS

Our review of procurement records showed that in January 1970 Mr. Inabinette requisitioned X-ray services from Gulf Coast because Ingalls did not have the necessary in-plant capacity to provide these services. Mr. Scordino, Director, Quality Assurance, approved the requisition, and Ingalls' procurement division awarded a subcontract to Gulf Coast. The subcontract specified that Gulf Coast was to:

"* * * provide all qualified labor, material and equipment to produce satisfactory radiographs for welder qualifications specimens and to monitor production welding [and] * * * provide service promptly at request of Ingalls' Manager, Industrial Lab, Nate Inabinette."¹

In February 1970 Ingalls received the first bill from Gulf Coast. Messrs. Inabinette and Scordino signed this bill to certify that the services Ingalls was billed for had been received.

During March and April 1970 the subcontract was changed to increase the amount of services to be supplied. We found that in late April 1970 the following unsigned handwritten entries had been made on a status sheet that was part of the subcontract file.

"Insurance certificate received - checked with insurance company * * * and they said that Gulf Coast was operated by W. N. Inabinette - Mr. Inabinette also supervises the Industrial lab at the West Bank - he writes P/R's [purchase requests] and signs the invoices. The whole situation appears to be a conflict of interest on the part of Mr. Inabinette and should be investigated."

"No more C/O [change orders] to be written against this order."

Additional changes were made to the subcontract in May and July 1970. In total, Gulf Coast billed Ingalls \$28,820 for services rendered under this subcontract. Ingalls paid Gulf Coast this amount, less \$167.10 for cash discount.

¹Nate Inabinette and W. N. Inabinette are the same person.

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In August 1970 an Ingalls attorney advised the Secretary, Litton Industries, of Mr. Inabinette's ownership interest in Gulf Coast but explained that, because (1) Gulf Coast did not presently do business with Ingalls and (2) Ingalls' procurement personnel were aware of Mr. Inabinette's interest in Gulf Coast, no conflict-of-interest appeared imminent. The Secretary stated that the attorney's explanation was adequate and that therefore Mr. Inabinette's conflict-of-interest statement would not be presented to the Litton Board of Directors, Conflict of Interests Committee.

In January 1971 Gulf Coast was awarded a second subcontract for X-ray services because its price was the lowest price offered by the three firms that had responded to the request for quotation. The offer made by Gulf Coast was signed by Mr. Inabinette as General Manager. He also acknowledged receipt of the subcontract in this same capacity.

Although an Ingalls attorney had stated in August 1970 that procurement personnel were aware of Mr. Inabinette's interest in Gulf Coast, it was not until May 1971 that Ingalls' Subcontract Administrator informed the Manager, Subcontracts, that:

"It has been brought to my attention that W. N. Inabinette, General Manager of Gulf Coast Inspection Service, is also the Section Manager of * * * Ingalls * * * Industrial Laboratory with responsibility to * * * Ingalls * * * for the direction and coordination of all nondestructive test functions required to support production schedules.

"It would appear that Mr. Inabinette's dual capacity might impair the objectivity of his judgment or enable him to use privileged information for personal gain, thus creating a conflict of interest.

"It is recommended that * * * Ingalls * * * management review this situation, and if a determination is made that a conflict of interest exists, Gulf Coast Inspection Service shall be removed from the bidders list."

On June 29, 1971, Ingalls terminated the subcontract and on June 30, 1971, directed that Gulf Coast be removed from the list of qualified bidders. Ingalls paid Gulf Coast \$14,384 for services received under this second subcontract.

The Director, Quality Assurance, prepared memorandums for Messrs. Inabinette's and Scordino's personnel files that recited the involvement of these employees with Gulf Coast. On October 20, 1971, Mr. Inabinette was discharged.

Mr. Scordino is still employed by Ingalls. In a memorandum to the Director, Quality Assurance, he admitted that he had aided Mr. Inabinette in incorporating Gulf Coast but stated that he had severed his relationship with Gulf Coast in November 1970. In a letter to Ingalls' internal auditors, the attorney who had handled the incorporation of Gulf Coast stated that while Mr. Scordino was an incorporator of Gulf Coast, Mr. Scordino had never served as a director or officer nor was he a stockholder.

WASTE HEAT BOILERS PURCHASED FROM
CONDENSER SERVICE ENGINEERING COMPANY, INC.

On March 30, 1972, Ingalls awarded a \$6.4 million subcontract to Condenser Service Engineering Company, Inc. This subcontract was for waste heat boilers for Navy ships. After award, the two Ingalls employees who were responsible for negotiating the award became President and Vice President of Condenser Service.

The facts show that:

- Mr. G. D. Trobaugh, the Ingalls Subcontract Administrator who negotiated the subcontract, resigned from Ingalls shortly after the award. He then became President of Condenser Service and later President and sole owner of CONSECO, a successor corporation to Condenser Service.
- Mr. Yoram Katz, the Ingalls Cognizant Engineer responsible for evaluating the technical proposals submitted by the firms competing for this subcontract, resigned from Ingalls on the day of the award. He then became Vice President of Condenser Service and is currently Vice President of CONSECO.
- An ex-employee of Condenser Service reported to Litton's Corporate Director, Security, an allegation that Messrs. Trobaugh and Katz acted together to insure that Condenser Service received the award.
- Ingalls' internal auditors reviewed the circumstances leading to the award and concluded that documentation was not sufficient to conclusively prove the truth of the Condenser Service ex-employee's allegation. However, their review raised questions regarding whether Condenser Service was a qualified bidder.

SUBCONTRACT AWARD

On February 24, 1972, Ingalls authorized Condenser Service to begin advance work in anticipation of the \$6.4 million subcontract (awarded on March 30, 1972) to design, develop, manufacture, test, and deliver the 90 waste heat

boilers. Mr. Trobaugh recommended this action after a 5-month procurement process but before receipt of the Navy's consent which is required for subcontracts exceeding \$100,000.

On February 29, 1972, in his memorandum summarizing the procurement process, Mr. Trobaugh stated that

- quality assurance has surveyed Condenser Service and found that quality requirements were met;
- on the basis of a complete technical evaluation, Condenser Service meets all the requirements; and
- this procurement has met the requirements of a truly competitive process and represents the best possible contract that could be obtained.

On June 6, 1972, Mr. Trobaugh resigned from Ingalls and was employed by Condenser Service. Condenser Service announced on July 15, 1972, in a trade publication, that Mr. Trobaugh had been appointed President and that another ex-Ingalls employee, Mr. Katz, had been appointed Vice President.

Ingalls' investigation of the award

In July 1972 an ex-Condenser Service employee informed the Litton Corporate Director of Security that he believed Messrs. Trobaugh and Katz had acted together to insure that Condenser Service received the subcontract. The Litton Corporate Director of Security informed us that he had received:

1. A copy of a letter dated April 20, 1972, from the Secretary and General Counsel of Condenser Service addressed to Mr. Yoram Katz (former Ingalls Marine Engineer, Propulsion Engineering, and Cognizant Engineer for the Condenser Service subcontract) offering him a loan of \$5,000.
2. A copy of a \$5,000 domestic collection letter dated April 28, 1972, addressed to a New York bank by a California bank for its customer, Yoram Katz.

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3. A copy of a deposit slip to the account of Gerald D. Trobaugh dated April 28, 1972, showing that a \$5,000 deposit had been made in the California bank by a check drawn on this same New York bank.

The Director of Security asked Ingalls' internal auditors to review the subcontract. On November 14, 1972, these auditors reported that it was impossible to determine from available documentation whether Condenser Service had been the beneficiary of inside information, as the ex-Condenser Service employee had alleged. They also reported that Condenser Service's proposal had received technical evaluations by only two Ingalls departments before the award, while Condenser Service's nearest competitor's proposal had been evaluated by eight departments. Both departments initially rated Condenser Service's proposal as not acceptable; however, one of them, Propulsion Engineering, made a reevaluation and rated the Condenser Service's proposal acceptable. Mr. Katz made the two Propulsion Engineering evaluations, but he did not state in either report his reasons for rating Condenser Service as not acceptable after the first evaluation and as acceptable after the second evaluation.

Ingalls' internal auditors reported that three other unissued technical evaluations had been written. One written by the Propulsion Engineering Group Leader favored Condenser Service's competitor. The other two, written by Mr. Katz, favored Condenser Service.

Two Ingalls departments, Safety and Integrated Logistics Systems, evaluated Condenser Service's proposal after the award. The Safety Department graded the proposal on a point system. The range of possible scores was from 0 to 150 points. Condenser Service's proposal received a score of 0. The Integrated Logistics Systems Department, whose range for evaluations is from 0 to 600 points, awarded the proposal a score of 40.

Ingalls' internal auditors also reported that they were unable to determine why the subcontract had been awarded to Condenser Service when its quality assurance program was rated as unacceptable and when the plant where the waste heat boilers were to be manufactured had not been surveyed.

Condenser Service did not acquire the plant where manufacturing was to be done until after the award; Ingalls did not perform a quality survey until September 1972, 6 months after the subcontract was awarded.

Our discussions with Mr. Trobaugh and review of records at Medford, Wisconsin, showed that:

- The Condenser Service manufacturing plant in Hoboken, New Jersey, according to Mr. Trobaugh, was antiquated and new facilities were needed to manufacture the waste heat boilers for Ingalls. Therefore, on May 1, 1972, 2 months after work under the subcontract had been authorized, Condenser Service acquired new manufacturing facilities in Medford.
- On July 28, 1972, CONSECO was formed as a Wisconsin corporation with Messrs. Trobaugh and Katz and three others as directors. The directors approved the issuance of 1,000 shares of CONSECO stock which were transferred to Condenser Service in exchange for the Ingalls subcontracts and other Condenser Service assets and liabilities.
- Mr. Trobaugh told us that he purchased the 1,000 shares of CONSECO stock from Condenser Service and paid for them with a \$300,000 personal demand note.
- Mr. Trobaugh denied receiving any type of kickback, loan, or payment in consideration for award of the Ingalls subcontracts. He also specifically denied receiving \$5,000 from Condenser Service or any of its representatives while employed by Ingalls.

HEAVY METAL PRODUCTS PURCHASED FROM

DACO INDUSTRIES, INC.

Ingalls awarded 22 subcontracts to Daco Industries, Inc., now bankrupt, after Ingalls procurement officials became aware that Daco was in critical financial condition. In all, Daco received 24 subcontracts valued at about \$7.8 million to manufacture various heavy metal products between March 1970 and February 1973. Ingalls is presently financing Daco to insure continued performance on the incompletd subcontracts.

WARNINGS OF DACO'S DETERIORATING
FINANCIAL CONDITION

Ingalls awarded two subcontracts to Daco in early 1970 and then discovered, before any other awards were made, that Daco was in critical financial condition. Ingalls, as early as June 1970, was concerned about Daco's financial status. In November 1970 the Subcontract Administrator reported events that raised doubt regarding Daco's financial solvency. As a result, he recommended that

--Ingalls visit Daco's facilities to verify progress under the two subcontracts Daco currently held and

--Daco's financial condition be checked out thoroughly before any more subcontracts were awarded.

In late December 1970 the Subcontract Administrator reported that the cash flow projections he had received from Daco were "* * * downright scary." He stated that his examination of these projections showed that Daco would be out of money by the middle or end of March 1971.

An Ingalls cost analyst also examined Daco's books and records and reported on February 24, 1971, that the placing of any additional orders should be delayed because:

--Daco would be in a negative cash position starting in May 1971.

--The ratio of fixed assets to long-term liabilities was 0.6:1, and the possibility of additional long-term financing had been exhausted.

--Daco's inventory level was too high, and Daco was experiencing problems in converting inventory into revenue.

--Daco's cash and receivables to current liabilities ratio was 0.8:1.

ADDITIONAL SUBCONTRACTS AWARDED TO DACO

After the warnings of Daco's deteriorating financial condition, as mentioned above, Ingalls awarded Daco 22 more subcontracts over the next 2 years, as follows:

<u>Period</u>	<u>Number of subcontracts awarded</u>
April to August 1971	6
September 1971	3
November 1971 to February 1972	9
June to August 1972	3
February 1973	<u>1</u>
Total	<u>22</u>

During these 2 years other reports were made within Ingalls regarding Daco's financial problems, as shown below.

--In September 1971 an Ingalls cost analyst reported that Daco was still experiencing cash-flow problems.

--In February 1972 Ingalls' Audit and Tax Department reported that:

"* * * Daco has experienced a relatively steady increase in the amount of assets employed. This can be a healthy sign of expansion and increased ability to perform. However, in DACO's case, much of this increase has been accomplished by increasing liabilities, a move which could cause serious cash flow problems in a company as lightly capitalized as DACO. This organization is very heavily debt financed. They have mortgaged virtually everything it is possible to mortgage, and in fact, have used the personal credit of the owners to guarantee certain loans." (Underscoring supplied.)

APPENDIX IV

--Also in February 1972 Ingalls' Small Business Liaison Coordinator recommended that Daco be dropped from the bidders list because Daco could already be "overbooked" with work.

--On July 24, 1972, an Ingalls cost analyst reported:

"* * * DACO is still experiencing problems in converting inventory into revenue."

"* * * DACO is over-extended in long-term debt and will have some difficulty in obtaining additional funds through long-term financing."

In February 1973 Daco's secured creditors refused to advance additional funds and forced Daco into bankruptcy.

REASONS FOR CONTINUED AWARDS

Most of the subcontracts were awarded to Daco because Daco offered the lowest price. However, the Ingalls Vice President of Materiel provided the following reasons for continuing to award subcontracts to Daco in light of its deteriorating financial condition.

--He could not rely on the Subcontract Administrator's warnings because he had no confidence in the Subcontract Administrator's expertise.

--Although he recognized that Daco had problems, he never had sufficient information to preclude Daco from consideration for additional awards.

Our review showed that, in addition to the Subcontract Administrator, two Ingalls cost analysts and employees of Ingalls' Audit and Tax Department also reported on Daco's financial problems.

An early report (November 1970) recommended that Ingalls compare actual progress at Daco to billed progress. This was not done until January 1973, shortly before Daco became bankrupt; overpayments to Daco of about \$389,000 were disclosed. The Ingalls Vice President of Materiel told us that not inspecting and verifying Daco's actual hardware completion earlier was a serious mistake.

DACO BANKRUPTCY

On February 17, 1973, Daco ceased operations. Ingalls terminated the subcontracts awarded to Daco that had not been completed. An Ingalls report cited the following disadvantages if Ingalls had to reprocur the items being manufactured by Daco.

- Additional cost of \$1,460,225 would be incurred.
- Hardware delivery delays of 2 to 5 months would be experienced.
- Overpayment (estimated at about \$389,000) already made to Daco would be unrecoverable.

For these reasons, the subcontracts terminated by Ingalls were combined into two subcontracts. Both of these subcontracts, in the form of Letters of Agreement, contained provisions that enabled Daco to resume operations.

Under the terms of the agreement, Ingalls will provide Daco up to \$560,000 for operating expenses and all material, except standard stock items, necessary to complete the work specified in the terminated subcontracts. At the conclusion of our review, an Ingalls attorney stated that Ingalls had advanced \$189,500 of the \$560,000 to Daco.

