DOCUMENT RESUME

03238 - [A2273378]

Shipbuilders' Claims--Problems and Solutions. PSAD-77-135; B-133170. August 9, 1977. 27 pp. + 7 appendices (36 pp.).

Report to the Congress; by Elmer B. Staats, Comptroller General.

Issue Area: Federal Procurement of Goods and Services (1900).
Contact: Procurement and Systems Acquisition Div.
Budget Function: National Defense: Department of Defense - Procurement & Contracts (058).
Organization Concerned: Department of the Navy; Department of Defense.
Congressional Relevance: House Committee on Armed Services; Senate Committee on Armed Services; Congress.

Navy procedures to ensure that shipbuilders' claims are reasonably settled have generally been adequate. Findings/Conclusions: Claims are usually made when Government changes or delays cause a contractor to incur higher costs because the work was different from, or in addition to, that specified in the contract. Contractors also claim increased costs for disruptions when Government changes cause unchanged contract work to be inefficient. Contractors must demonstrate a cause and effect relationship between a Government act and resulting increased costs. The settlement of claims is aggravated because the exact value is hard to pinpoint. In two of four claims reviewed, contractors overstated their claims, and settlement was delayed due to inadequate documentation. Recommendations: The Navy should: provide specific instructions in future ship construction contracts to contractors on the minimum documentation required to be submitted or to be readily available in support of claims; develop standard guidelines to be used in settling claims for disruption; determine a contractor's entitlement to interest as early as possible, allow prompt temporary payment on individual line items, and settle each claim line item wherever possible after it is analyzed; and analyze the underlying causes of each claim after settlement to make sure that corrective measures in contracting practices are working to prevent future claims. (Author/SC)

# REPORT TO THE CONGRESS

## BY THE COMPTROLLER GENERAL OF THE UNITED STATES

# Shipbuilders' Claims-- Problems And Solutions

## Department of the Navy

Navy procedures were generally adequate to make sure claims were reasonably settled. In two of four claims reviewed, contractors overstated their claims and delayed settlement because of inadequate documentation.

Improvements are needed in

--obtaining data from contractors,

--analyzing claims for disruption,

--paying claims, and

--analyzing Navy's settled claims.

PSAD-77-135

AUGUST 9, 1977

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

B-133170

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the shipbuilders' submission of four contract claims against the Navy and the reasonableness of the settlements.

Our review was made to find out how the Navy processes a claim, the problems in settling claims, and what actions are necessary to improve settlements and reduce claims in the future.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1952 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget, and to the Secretary of Defense.

James B. Stetta

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

# SHIPBUILDERS' CLAIMS--PROBLEMS AND SOLUTIONS
Department of the Navy

## D I G E S T


Claims are usually made when Government changes or delays cause a contractor to incur higher costs because the work was different from, or in addition to, that specified in the contract. Contractors also claim increased costs for disruptions--when Government changes cause work on unchanged contract work to be inefficient.

Delays and disruptions can also be caused by contractors or acts of God, in which case contractors cannot receive compensation from the Government. Because of this, contractors must demonstrate a cause and effect relationship between a Government act and resulting increased costs.

The settlement of claims is aggravated because its exact value is hard to pinpoint. This happens because shipbuilders cannot account, with mathematical accuracy, for all costs attributable to Government actions.

Contractors should provide, or have readily available, accurate and adequate supporting documentation when a claim is filed, and the Navy should require this documentation as a prerequisite to settling a claim.

Of four claims valued at $315 million:

--Parts of two of the four claims were overstated and adequate support for them was not provided, or made readily available, to the Navy when they were submitted. This caused delay in settlement and added cost to the Navy; in one instance, the Navy spent 89 staff-years to analyze a claim at a cost of $1.7 million. (See ch. 2.)

--Navy procedures are generally adequate to reach reasonable settlements. However, standard guidelines for settling the disruption portions of a claim should be developed. (See ch. 3.)

Guidelines developed by the Navy for contracting officers to use to determine needed contractor support for a claim are not legally binding and contractors may decline to follow them. (See ch. 2.)

Contractors and the Navy would benefit if prompt provisional payment were made to contractors for portions of claims. Also, the Navy should settle claims on an individual line-item basis wherever possible; that is, each item listed in the claim should be looked at separately. These changes should help relieve contractors' financial problems; speed settlements; and, in some cases, reduce the total cost of settlement to the Navy. (See ch. 4.)

While the Navy has settled over $1 billion in claims since 1972 when it instituted measures to prevent claims and to improve claims settlement, shipbuilding claims under review by the Navy still amounted to $2.48 billion. The Navy does not believe that the current large backlog indicates shortcomings with its claims prevention measures. It believes that effectiveness of its management will be seen as the Trident and Patrol Frigate construction programs progress, since these programs were recently started and benefited from the management and contracting changes made in the last few years. However, a limited examination by GAO of one recently awarded contract for tankers (a relatively simple noncombatant vessel) has shown that many unilateral contract changes by the Navy continue and that the parties have been unable to agree on pricing these changes which may result in claims. (See ch. 5.)

GAO believes that the Navy can measure the effectiveness of those claims prevention measures--without waiting for new programs to be completed--by analyzing the causes of recently settled claims.

## RECOMMENDATIONS

The Navy should

--provide specific instructions in future ship construction contracts to contractors on the

minimum documentation required to be submitted, or to be readily available, in support of claims;

--develop standard guidelines to be used in settling claims for disruption;

--determine a contractor's entitlement to interest as early as possible, allow prompt temporary payment on individual line items; and settle each claim line item wherever possible after it is analyzed; and

--analyze the underlying causes of each claim after settlement to make sure that corrective measures in contracting practices are working to prevent future claims.

NAVY AND CONTRACTOR COMMENTS

The Navy generally agreed with the facts presented and the conclusions reached in the report and revised its procedures to allow provisional payment on claims. (See app. VII.)

The contractors were provided excerpts of chapter 2 that dealt with their claims and related delays in settlement attributed to them. The contractors completely disagree with the information GAO presented indicating that they overstated their claims, in some instances, or that they were in any way responsible for the delays that occurred in settling their claims. (See apps. III to VI and pp. 6 to 10.)

# Contents

## ABBREVIATIONS

| | |
|---|---|
| ASBCA | Armed Services Board of Contract Appeals |
| ASPR | Armed Services Procurement Regulation |
| DCAA | Defense Contract Audit Agency |
| GAO | General Accounting Office |
| GFP | Government-furnished property |
| Min/hr | Minutes per labor-hour |

## GLOSSARY

| | |
|---|---|
| Change | Any Navy action that causes a revision, or addition, to the contractor's original construction plans. |
| Claim | A contractor's demand for increased compensation because of an alleged constructive or formal change, an express contract clause, or both (refer also to app. II for more detailed discussion). |
| Constructive change | A change based on Government conduct, including actions or inactions, which is not a formal written change order but which has the effect of requiring the contractor to perform work different from, or in addition to, that prescribed in the original contract. |
| Degree of disruption | A judgmental expression of the severity of a disruptive action. |
| Disruption | Disruption is the additional effort in performance of the basic contract work by the contractor, resulting from Government or contractor actions or inactions which interfere with, or restrict, performance efficiency causing added cost. |
| Delay | A delay in ship delivery, caused by action or inaction by the Government, resulting in added cost for continuing overhead and the like. |
| Interest expense | A contractor's cost of borrowing funds or use of contractor's equity capital to finance change work. |
| Rate of disruption | A quantification of the degree of disruption expressed in additional minutes per labor-hour. For every hour of original contract work planned there would be assigned a certain number of minutes as the extra time it took to do the work because of a change. |
| Request for equitable adjustment (REA) | Contractors' demands for increases in contract prices based on events which allegedly fall within the coverage of express contract provisions (see app. II for further explanation). |

# CHAPTER 1

## INTRODUCTION

The Navy awards a contract for a ship after it has a plan on (1) how to build it, (2) the sequence of its construction, and (3) the time required to complete it. This information forms part of the basis for the contract price.

Changes or delays caused by the Navy--including errors or ambiguities in its plans and specifications that need to be corrected--can increase costs, delay construction, and lead to claims against the Navy. Claims for price increases are frequently based on the premise that Government action or inaction caused the contractor to incur higher costs because its work was different from, or in addition to, that specified in the contract. Contractors claim increased costs not only for the direct costs of changes but also for the inefficiencies they experience due to the effects these changes may have on unchanged contract work. These effects are commonly referred to as disruption.

Because delay and disruption costs can also be caused by the contractor, or acts of God for which the Government is not liable, the Navy requires a contractor to demonstrate causality between claimed increased costs of delay and disruption and a Government-caused action.

The Navy has long recognized many causes of claims and has taken extensive improvement actions and acquisition management actions to help prevent future claims. We evaluated those actions and commented on them in a report issued on February 28, 1972, entitled "Causes of Shipbuilders' Claims for Price Increases" (B-133170).

## HISTORY OF SHIPBUILDING CLAIMS, SETTLEMENTS, AND CURRENT BACKLOG

In 1972 the Navy shipbuilding claims backlog reached an unprecedented dollar value of nearly $1.4 billion, and the Navy was incapable of determining Government responsibility in a timely, comprehensive, and professional manner. For that reason, the Navy refined its claims evaluation procedures and adopted a multidisciplined team approach (i.e., a claim settlement team composed of a contracting officer, legal, technical, and audit representatives) for resolving major claims. Shipbuilding claims, which were submitted after the new claim evaluation procedures were implemented in 1972, have been negotiated in an average of 13 months as compared to 60 months for claims submitted prior to 1972.

Beginning early in 1974, the Navy began to make substantial progress in settling outstanding claims and reducing its claims backlog. During the period January 1, 1974, through June 30, 1976, the Navy settled about $1 billion in shipbuilding claims for about $400 million. However, as of January 1977, shipbuilding claims under review by the Navy reached a new high of $2.48 billion. Thus, although the Navy has been successful in negotiating settlements, it still has a long way to go.

We issued a report on April 28, 1971 (B-171096), which presented an analysis of the Navy's claim settlement procedures. In that report, we concluded that the Navy did not have enough information linking the additional costs claimed to actions of the Government, and, therefore, had insufficient assurance that the settlements were fair and reasonable.

In this report, we present an evaluation of the Navy's claims settlement procedures used in four recent cases. We have considered whether the Navy settled those claims with adequate assurance that Navy action caused the increased costs and whether approaches used in settling claims can be improved. Further, we identify areas where the Navy can reduce the time necessary to pay contractors the legitimate portions of their claims, thereby possibly reducing future settlement amounts by eliminating some interest expense.

We also seek in this report to clarify apparent misunderstandings related to the relatively small amount of the claim settlements compared to the initial claim. (See app. II.)

## CHAPTER 2

## CONTRACTORS' CLAIMS HAVE BEEN OVERSTATED AND NOT ADEQUATELY DOCUMENTED

Navy Procurement Directives require that a contractor's claim include support for: (1) a legal basis of entitlement, (2) facts meeting the elements of proof required to support the basis for entitlement, and (3) adequate factual support for the amounts claimed. In addition, the contractor is required to demonstrate causal support and documentation of the amounts claimed in as much specificity as the facts will permit.

The Navy is even more specific in guidance for supporting the cost of one of the major claim elements known as disruption. Portions of the Ship Acquisition and Contract Administration Manual (hereafter referred to as the Navy Contract Administration Manual) require contracting officers to obtain the following supportive information:

1. Description of disruptive elements and exactly how work has been or will be disrupted.

2. Period of time when the disruption occurred, or will occur.

3. Area(s) aboard ship, or in the shipyard, where the disruption occurred, or will occur.

4. Trade(s) disrupted, with a breakdown of labor-hours for each trade.

5. Scheduling of trades before, during, and after the period of disruption.

6. The measures taken by the contractor to reduce disruption.

These requirements to demonstrate causal support with specific documentation are the source of a longstanding and still unsolved problem the Navy has with shipbuilders which submit disruption claims. That is, the types of documentation contractors use to support their assertions of Navy-caused disruption and/or delay have been different from the documentation which the Navy requires to reach what it believes is a well-supported settlement position.

A part of this problem rests with the imprecise nature of disruption and delay claims resulting from contractors' inability to account, with mathematical accuracy, for all such costs attributable to Government actions. While the contractor has the burden of proving its claim by establishing that a Government act or omission caused increases in costs, its books and records do not generally demonstrate the precise amount of delay and disruption costs. Since delay and disruption can be partly viewed as inefficiency, it is beyond reasonable expectation to believe that labor records alone will accurately reflect the amount. On this point, the Armed Services Board of Contract Appeals (ASBCA) has stated:

> "It is simply not possible to prove the amount of an equitable adjustment for a constructive change with mathematical precision. In developing such a claim, a contractor must rely on estimates, which, in turn, allows considerable leeway for negotiation. In Ingalls Shipbuilding, Litton Systems, Inc., ASBCA No. 17717.76 1 BCA ¶11,851, at p. 56,727, we noted that the costs claimed there were based on estimates rather than segregated costs, and that this was in keeping with the general practice in industry at that time. The observation applies with equal force here. Similarly, appellant's use of different theories, for which separate claim periods were developed, is consistent with the stated purpose of its claims, namely, to afford a basis on which to negotiate a settlement."

The Navy recognizes the contractors' inability to account precisely for these kinds of costs. Therefore, with regard to these and other types of costs, the Navy uses a great deal of reasoned engineering, business and legal judgment, and its own and contractors' analyses to arrive at estimates which are used in support of the final settlement. There must be documentation of the basis for contractors' estimates and judgments, however, and this is where contractors have been most deficient.

The other part of the problem is that although Navy directives and the Contract Administration Manual contain guidelines on the type of information which should be filed with a claim, these documents are not legally binding and thus, contractors may decline to follow them. Yet another problem is that the distinction between claims settlement by negotiation or by litigation has become blurred. If a claim is litigated through failure of negotiation, the contractor must present sufficient proof to establish its right to added

compensation and the amount. The Government must then present sufficient facts to either disprove what the contractor has contended or establish a legal defense to the contractor's right to recover. This all occurs in a procedurally structured process. But in the preceding negotiation process, Navy requests for additional information are regarded by the contractors as requests for assistance in disproving their claims. This may account for their reluctance to cooperate in honoring requests for information. Nevertheless, we believe the Navy has a right to ask for and receive accurate information promptly when requested.

We observed, for each of the four claims discussed in chapter 3, that after a claim was filed, the Navy requested additional data from contractors it felt was specifically needed to perform a claims analysis. In some cases the Navy was provided with inaccurate data, encountered delay in obtaining requested data, or had to reconstruct what it believed should have been provided by the contractor. In addition, the Navy's analysis revealed that some of the claim amounts were overstated.

## CLAIMS WERE OVERSTATED

Two of the four claims were, in parts, significantly overstated by the contractors. The amount of the claims in relation to the contractors' costs caused the Navy to doubt the reasonableness of the claims. These doubts were borne out when the Navy analyzed the claims.

### Avondale claim

The Avondale claim for $169.1 million was filed under two contracts valued at $350.4 million. Since the contractor reported incurred costs under these contracts of $418.6 million, the $169.1 million claim would have given it a profit of $100.9 million, or more than 24 percent. The amount of the claim, on its face, seemed overstated inasmuch as the contractor initially proposed a profit of only 5 percent for the basic contract, which was subsequently modified by the Navy in negotiations to 7 percent. (See app. I.)

In its analysis of the claim, the Navy found that labor costs claimed exceeded actual booked costs by $11 million. Specifically, the contractor claimed that the Navy should pay for a total of 32.8 million labor-hours consumed in completing the contracts. In its claim analysis, the Navy found that the contractor had booked a total of 31.2 million labor-hours on the entire program, or 1.6 million labor-hours less than it was seeking to recover from the Navy.

The 1.6 million unbooked labor-hours increased the claim by an estimated $11 million.

Bethlehem Steel claim

The Bethlehem Steel claim for $49.6 million was filed in connection with a contract valued at $50.4 million. The contractor reported incurred costs under this contract of $76.3 million, and had the $49.6 million claim been accepted it would have provided a profit of $23.7 million, or 31 percent. In its proposal for the original contract, the contractor indicated it was offering a price that included no profit. (See app. I.)

In its analysis of the claim, the Navy found two specific elements for which the costs appeared unreasonable--one by $12 million and another by almost $0.7 million.

The contractor claimed that an additional $12 million in costs was incurred on the company's commercial ship program because of Navy actions on the Navy ship construction program. Specifically, Bethlehem Steel claimed that labor had to be transferred from the commercial program to the Navy program because of Navy action and that this caused a reduction in work efficiency on the commercial ships. Subsequently, the Navy, itself, developed schedules of incurred labor-hours for both Navy and commercial work. It found that the contractor had not given preference to Navy work, but had actually given preference in manning to its commercial work.

In the other instance the Navy found, as it had under the Avondale claim, that the contractor attempted to recover over 91,000 more labor-hours under the claim than it had actually incurred under the contract. These excessive labor-hours resulted in an estimated overclaim amount of almost $0.7 million.

CLAIMS NOT ADEQUATELY DOCUMENTED

Of the four claims reviewed, the Navy told us that only the claim submitted by General Dynamics was adequately documented at the time it was submitted. The fact that the other three claims were not adequately documented not only increased the Navy's cost to analyze the claims but also extended its analysis time, thereby causing delays in settlements. Examples of the three claims which were not adequately documented follow.

## Avondale documentation

The Navy claims team reported that although data provided by the contractor was traceable to its records, much of the corroborative data the Navy needed for its analysis was not provided by the contractor.

In this case, the Navy reportedly spent 89 staff-years of effort at a cost of $1.7 million to analyze data and settle the claim. According to a member of the Navy claims settlement team, the major reason for this time-consuming and costly effort was that the Navy had to conduct its own independent analysis because the contractor did not provide documentation demonstrating a cause and effect relationship between Navy actions and increased contractor costs.

## Bethelehem Steel documentation

When the contractor first filed this claim with the Navy early in 1971, the Navy attempted to get additional supporting documentation. This attempt continued for almost 2 years until early 1973. Eventually, the claims team concluded that it could not evaluate a large portion of the claim because the contractor failed to provide a basis for evaluation, and thus the team developed its own method for determining the effects of Navy-caused disruption under the contract. In other words, the Navy spent effort to develop data which the contractor should have provided. In addition, the Navy claims team said that some of the data that the contractor did provide was either erroneous or inaccurate which, in turn, hampered its evaluation. In one case the contractor provided data that it revised numerous times over a period of 15 months.

## Newport News documentation

The Navy claims team reported that the contractor did not provide adequate data to support key events concerning alleged Navy-caused delays under the ship construction program. The team tried to obtain data from the contractor during its analysis and had to wait long periods of time to get data it believed the contractor should have submitted when the claim was filed. The Navy claims team had to reconstruct labor force loading charts for the ships in order to analyze the claim. These charts were not provided by the contractor even though they were a normal part of its ordinary records and were requested by the Navy claims team.

## CONCLUSION

In both the Avondale and Bethlehem Steel claims, the overstated claims were found only after analysis was

performed by the Navy. It is reasonable to expect that, in matters of such complexity, intensive analysis by the Navy must be performed and that weaknesses in the claim would be disclosed. But, we believe the size and nature of these disparities necessarily call into question the degree of care exercised by the contractors in preparing and presenting the claims.

In our opinion, contractors should provide, or have readily available, accurate and adequate supporting documentation at the time a claim is filed and, the Navy should require such documentation as a prerequisite to settling a claim. The contractor has the legal burden of proving its claims, and that burden must be carried by providing sufficient support to establish the facts that it alleges. We believe that such documentation will not only provide the Navy with information it needs to identify payable portions of claims but also will reduce Navy's analysis costs and the time needed to settle claims.

## RECOMMENDATION

We recommend that the Secretary of the Navy revise the procurement directives to require that future ship construction contracts include specific instructions to contractors on minimum requirements for documentation to be submitted, or to be readily available, before they submit claims or requests for equitable adjustments for Navy review. In this regard, the Navy should consider including in these requirements the guidelines which are currently contained in chapter 13 of its Contract Administration Manual relating to disruption.

## CONTRACTOR COMMENTS

We sent portions of this chapter to each of the four shipbuilders for its comments. These comments are included in appendixes III through VI. Our response to these comments follows.

The four contractors disagreed with chapter 2 of the report which we sent to them for comment. They expressed concern about our objectivity and raised other points which they believed should have been considered in our review. Their concerns are understandable since they only saw the part of the report which comments on their claim submisssions. We believe our recommendation that the Navy specify the minimum requirements for doucmentation in support of a claim, and the several recommendations in the remainder of the report should benefit the contractors.

Avondale shipyards provided more extensive comments which are discussed below.

Avondale

Avondale Shipyards has provided, through its parent company, Ogden Transportation, extensive comments that undoubtedly have some merit regarding previous attempts to settle the claim. Avondale has provided a history of the claim from 1969 leading up to the final claim submitted in 1974. We have previously reported to the Congress that the Navy was responsible for mismanagement of early attempts to analyze and settle claims. Our purpose in this review was to evaluate the Navy's settlement of Avondale's final claim which occurred during the period April 1974 through June 1975.

1. Avondale indicated little or no prior knowledge of our review.

   We made the major portion of our review at the Navy Sea Systems Command, the Naval Material Command, and at the Supervisor of Shipbuilding Office responsible for work at the Avondale Shipbuilding Company. These were Navy locations where the documentation for the claim furnished by the contractor and the Navy's documentation of its claim analysis were located and the contractor was made aware of our audit. We did meet, however, with Mr. R. F. Brunner, Vice-President of Avondale Shipbuilding Company on August 8, 1976, to discuss the purpose of our review and to obtain comments on several points covered in our review.

2. Avondale has stated that our conclusion that its $169 million claim was overstated was based on the settlement for $80 million.

   We stated that if the full amount of the $169 million claimed were allowed, the contractor would have yielded a profit of 24 percent based on incurred costs of $418 million, thus demonstrating that its very size was overstated. Avondale is incorrect in stating we presumed the claim was overstated based on comparing the settled amount to the claimed amount. In fact, we agree with Avondale that such a simple comparison is misleading and does not, in itself, demonstrate any wrongdoing.

3. Avondale disagreed that the claim was overstated by $11 million.

   The fact that Avondale was aware of the overclaim and notified the Navy (see attachment to Avondale

letter app. III) does not alter our describing the claim as overstated.

The notification did not state the amount of the overclaim or where it occurred nor did Avondale expressly reduce the face amount of the claim. Records show that the Navy advised Avondale in April 1975, which was 4 months later, that claimed labor-hours exceeded incurred labor-hours by 1.6 million hours. The Navy told us that it developed the amount and the nature of the overclaim without benefit of Avondale's assistance. The Navy actions and not Avondale's resulted in reducing the amount of the claim by $11 million for overclaimed labor-hours.

4. Avondale asserts that it did not delay submitting documentation to the Navy and that the Navy did not reconstruct data which should have been provided by Avondale.

We maintain that contractors are required to support claims against the Government at the time a claim is filed.

In this regard the Navy explained to Avondale on May 10, 1974, that any claims package presented to the Navy must have the supporting facts or documentation attached or an indication of where the supporting facts or documentation can be seen. On October 30, 1974, 6 months later, the Navy notified Avondale that its analysis of Avondale's claim for delay was time consuming because of the reluctance by Avondale to substantiate portions of the claim.

Regarding the contractor's statement that the Navy did not reconstruct data which should have been provided by the contractor, we found, for example, that the Navy claims team had to construct time-phased schedules of incurred labor-hours which took a major effort by the claims team.

The Navy claims team manager estimated that about one-half of the 89 staff-years spent by his team to analyze the Avondale claim was the result of the contractor's failure to promptly provide the claims team with needed supporting data or that the Navy had to construct data which the contractor should have provided.

## CHAPTER 3

## EVALUATION OF THE NAVY CLAIM SETTLEMENT POSITION OF SELECTED CLAIMS

To review the Navy's shipbuilding claim analysis procedures, we selected four recently settled claims and evaluated the Navy's analyses for selected items of each claim. The Navy settled the four claims by using its multi-disciplined team approach (i.e., a claim settlement team composed of a contracting officer, legal, technical, and audit representatives).

The four claims were valued by the shipbuilders at $315 million and were settled by the Navy for $144 million. The following schedule lists the four claims and a breakout of the Navy's settlement position by segments classified as (1) technical and audit, (2) profit, and (3) litigative risk.

Schedule of Selected Settled Claims

| Contractor and ship program | Amounts and percentages of Government settlement position by segment | | | | | Settlement as a percent of contractor claim |
|---|---|---|---|---|---|---|
| | Contractor claim amount | Technical and audit | Profit | Litigative risk | Total settlement | |
| | (millions) | | | | | |
| Newport News Shipbuilding and Dry Dock Company: | | | | | | |
| Amphibious cargo ships (LKAs) | $ 29.1 | $ 10.4 | $1.4 | $ 2.6 | $ 14.4 | 49.5 |
| Avondale Shipyards, Inc.: | | | | | | |
| Destroyer escorts (DEs) | 169.1 | 66.1 | 2.0 | 11.9 | 80.0 | 47.3 |
| Bethlehem Steel Corporation Sparrows Point Yard: | | | | | | |
| Ammunition ships (AEs) | 49.6 | 13.7 | 1.8 | 1.5 | 17.0 | 34.3 |
| General Dynamics Corporation Quincy Shipbuilding Division: | | | | | | |
| Submarine Tenders (ASs) | 67.5 | 22.0 | 3.5 | 7.5 | 33.0 | 48.9 |
| Total | $315.3 | $112.2 | $8.7 | $23.5 | $144.4 | 45.8 |
| Percentage (note a) | | 78 | 6 | 16 | 100 | |

a/These percentages are provided to show the relative amounts of each segment of the final claim.

The technical and audit segment is determined by the Navy's factual investigation conducted through engineering evaluation and analysis of the technical merits of the claim and verification of contractors' costs through audit. The profit segment is part of the technical and audit position and is usually developed by the claims team using methods prescribed in the Armed Services Procurement Regulation

(ASPR). The litigative risk segment represents the claims team's legal assessment of the probable amount which the Armed Services Board of Contract Appeals or the Court of Claims might allow the contractor beyond the technical and audit position amount, if the claim were appealed. (See app. II for a discussion of the assessment of litigative risk.)

All four contractors had reported losses on the related contracts before the claims were settled. After settlement, three of the contractors still reported losses under the contracts while one contractor reported a profit. (See app. I.)

There are three broad categories of claim elements: formal and constructive changes, delay, and disruption. The Navy used a different approach in its analysis of each claim category, as discussed below. Also presented below is a discussion of four different techniques the Navy used to analyze the disruption category of each of the four claims.

## NAVY ANALYSIS OF FORMAL AND CONSTRUCTIVE CHANGES

Both formal and constructive changes have the effect of requiring the contractor to perform work different from, or in addition to, that prescribed by the original terms of the contract. A formal change is a written order under the changes clause of the contract, directing the contractor to make a change. A constructive change is based on Government action or inaction which has the legal effect of a change without a written change order.

Although the Navy does not follow exactly the same approach in analyzing each change in every claim, a general set of steps is usually followed. The analyst will: review applicable ship specifications and contract plans, examine calculations and correspondence supplied by the contractor, hold discussions with the contractor and Supervisor of Shipbuilding, conduct onsite inspections of the affected vessels when practical, review contractor accounts of incurred labor, and perform independent calculations. The facts obtained from these steps form the basis for the technical analyst's position, which is presented in the Navy's final technical analysis report.

We reviewed the Navy analyses of the "changes" element of the four claims and found no indication that applicable procedures were not followed or that the approach taken was unreasonable.

## NAVY ANALYSIS OF DELAY

Delay refers to an extended period for construction performance beyond the original contract completion date. Such delay generally causes the contractor to incur higher costs than planned as a result of such items as (1) increased cost of performing original contract work in a later than planned time period; (2) continuing certain fixed-direct costs such as housekeeping and security; (3) excess Federal Insurance Compensation Act (FICA) taxes; (4) continuing or unabsorbed overhead; and (5) support labor during the extended period of performance.

The computation of delay costs is usually more complex than the determination of the cost of the change itself. Normally, contractors submit a total cost claim which, in effect, asserts Government responsibility for the entire delay. Such claims make it difficult for the Government to sort out the reasons for and related increased costs of delay, especially when non-Government causes have contributed to the delay. In these situations the Navy analyst must analyze the changes or the alleged causes of delay in the light of the contractor's construction plans and actual experience. In this regard, the Navy analyst needs additional information, such as main events schedules, production control calendars and shipway schedules, to help him highlight the factors causing delay and allow him to make estimates of increased costs. The technical analyst's position on delay is also presented in a final technical analysis report.

We reviewed the Navy's analysis of the "delay" element of the four claims. We found no indication that the established procedures were not followed or that the approach taken was unreasonable.

## NAVY ANALYSIS OF DISRUPTION

The most complex claim element, and thus the one least subject to analysis and documentation, is disruption. It is the loss or reduction of productivity experienced on the overall contract work when Government changes or delays operate to change the sequence, length of time, or level of manning of any given task. Normally, disruption is the result of many changes, some for which the Government is responsible and some for which it is not. The extent of disruption is contingent on many factors, including the percent of ship completion at the time a change occurs, and the impact of changes on all ongoing contract work. In addition, if a change is complex, more disruption will usually be experienced than if the change were relatively simple. In all the claims we reviewed, the contractor

claimed disruption based on the effects of Government changes that took place during construction.

Despite the problems in analyzing disruption, there was a lack of guidance for Navy claim analysts, resulting in many different approaches to analysis. A different disruption analysis approach was used on each of the four claims reviewed. Further, only the Navy analysis of disruption on the Avondale claim related both the complexity of the change to the amount of disruption by establishing objective criteria and accounted for both Government and non-Government causes of disruption. While the complexity of the change on other claims was considered, it was done by using personal judgments only.

The following is an explanation of the different disruption claims analyses conducted by the Navy for the four claims.

Avondale "DE" disruption claim analysis

The Navy performed two independent analyses of this claim. The first analysis focused on the disruptive effects of claimed changes and the other focused on identifying non-Government causes of disruption. The analysis of Government-caused disruption was performed in two phases: First, the Navy established relationships between the amounts of allowable work directly related to a change, the complexity of a change, and the amount of disruption which potentially occurred. Second, the Navy engineer made a detailed review of the facts, both those presented by Avondale and those collected independently, to determine the credibility of the contractor's facts as to where and to what extent disruption occurred. The combined results of these two steps formed the basis for the Navy's position on allowable disruption costs.

The second analysis attempted to quantify the effects of non-Government causes of disruption. Included in this analysis were assessments of cost of labor inefficiency resulting from skilled labor shortages, labor turnover, and new facilities construction which interfered with worker movements. This analysis resulted in identifying both Government and non-Government causes of disruption and disallowing labor-hours to which the contractor was not entitled.

Thus, in its analysis of the disruption portion of the Avondale claim, the Navy considered the complexity of the changes and also non-Government causes of disruption. A

similar analysis was not performed on the other three claims.

General Dynamics "AS" disruption claim analysis

General Dynamics attributed a portion of its disruption claim directly to defective contract design. The remainder of the disruption claim was related to the combined effects of all changes on the original contract work.

The Navy's analysis of defective contract design disruption included an evaluation of those time periods when alleged disruption occurred and an identification of those areas of the ships alleged affected by the defective contract design problems. Based on the Navy engineers' judgments, an estimate of the allowable disruption was made.

For disruption associated with the combined effects of all changes on the original contract work, the contractor claimed Navy changes caused it to lose efficiency in achieving the proper mix of skilled to unskilled workers and it also experienced excessive overtime. Both of these are recognized sources of ineffeciency, provided they can be demonstrated as attributable to changes or other Government actions. The Navy's approach here was to reconstruct, by quarter, the number of skilled and unskilled workers in the yard and the amounts of overtime experienced. The Navy did find the Government changes were a source of lost efficiency.

In order to assure that there were no non-Government sources of disruption, the Navy also reviewed the effects of non-Government causes. No attempt was made, however, to establish objective criteria to measure the relationship between the complexity of changes and the resulting disruption as was done on the Navy analysis of disruption on the Avondale claim discussed above.

Newport News LKA disruption claim analysis

A range method was used by the contractor and accepted by the Navy analyst as a reasonable method of computing disruption. This method relied entirely on engineering judgment, since the contractor assigned a rate in minutes per labor-hour (min/hr), based on an assessment of the degree of disruption experienced against regular hourly work during a particular time period. These rates fell into ranges as follows:

| Degree of disruption | Rate of disruption |
|---|---|
| Slight | 1 through 2.99 min/hr |
| Moderate | 3 through 5.99 min/hr |
| Severe | 6 and above min/hr |

If an engineer, for instance, decided there was moderate disruption during a specific time period, he would assign from 3 to 5.99 minutes of disruption for every hour of original contract work performed during that time period.

The Navy, in this claim, did not try to quantify the disruptive effects of certain non-Government causes of disruption, nor did it attempt to establish relationships between the complexity of changes and amounts of disruption.

Bethlehem Steel AE disruption analysis

The Navy's analysis of this claim differed considerably from the other three analyses reviewed because it concentrated on determining contractor losses because of excess labor-hours resulting from non-Government causes of disruption, rather than from Government-caused disruption. The primary factors of non-Government excess labor-hours identified were: (1) low contractor estimates of labor-hours in the original contract, (2) a skilled labor shortage due to the demands of the construction industry, and (3) Bethlehem Steel's decision to accept too much construction work for which not enough labor could be attracted. These factors were quantified and deducted from the total disruption claim, resulting in the balance being identified by the Navy as possible Government-caused disruption. The Navy then accepted the contractor's quantification of disruption and allocated the balance of possible Government-caused disruption in the same proportion as the contractor had claimed.

No attempt was made by the Navy to (1) assess the disruptive impact of the Government-caused changes nor (2) establish objective criteria to measure the relationship between the complexity of changes to the amounts of disruption; rather, the Navy accepted the contractor's method of allocation.

CONCLUSION

From our review of the four shipbuilding claims, we believe the Navy claim settlement procedures if diligently pursued are generally adequate to reach reasonable settlements that are fair to both parties. We believe, however, that the Navy can improve its analysis of the disruption

claim element and provide itself with further assurances of reasonableness. Toward this end, increased use of the Navy's approach in resolving disruption in the Avondale claim should be considered.

Since disruption can be caused by Government and non-Government actions, we believe the Navy should assess the impact of both types of actions on the contractor's performance. Furthermore, we believe attempts should be made, to the extent possible, to establish objective criteria to measure the relationship between the complexity of a change and the amounts of disruption and not merely rely completely on the personal judgments of Navy analysts.

## RECOMMENDATIONS

We recommend that the Secretary of the Navy

--review the many disruption claims analysis approaches used in the past,

--identify strengths and weaknesses in each,

--determine which procedures most closely protect the Government's interests and satisfy the Navy Procurement Directives, and

--develop standard guidelines for future analyses.

## AGENCY COMMENTS

We presented our views to Navy officials who told us they are developing standard guidelines.

# CHAPTER 4

## PROMPT PAYMENT OF CLAIMS WILL BENEFIT THE NAVY AND CONTRACTORS

After completing an analysis of a claim, the Navy begins settlement negotiations, generally on a total price basis. Therefore, amounts determined allowable to the contractor during the Navy's analysis process may not be paid until all analysis work is completed and the claim is settled in total. Delays in paying contractors' allowable claim amounts can increase their burden in financing these costs. This can create critical cash flow problems for the contractors and damage the business relationship between the contractors and the Navy. In fact, we believe this to be a major factor contributing to the poor relations between the Navy and the shipbuilders.

During this review we identified two possible methods for paying the contractor allowable amounts as the Navy's analysis is completed on individual claim line items. One method is more liberal use of provisional payments to the contractor and the other is negotiating individual line items as the analysis of each item is completed.

Prompt payment of contractor claims, in addition to alleviating contractor cash flow problems, can also offer the Navy a means to reduce, or eliminate, the payment of interest to the contractor on allowable claim amounts.

### PAYING ALLOWABLE CLAIM AMOUNTS AS THE NAVY ANALYSIS PROGRESSES

As mentioned above, liberalizing the Navy provisional payment policy, or using line-item negotiations as each analysis is completed, would allow earlier payment to contractors of legitimate claim amounts. Both methods require the Navy to determine the contractor's entitlement and the amount of compensation based on the merits of the claim.

#### Need for liberalized provisional payment policy

A provisional payment is a payment made on condition that the contractor is ultimately found to be entitled to the money. If, after further analysis, it is determined that the contractor is not entitled to the money (or is entitled to a lesser amount), the contractor must repay the Goverment. In such cases, the Government receives interest on the overpaid amount.

To make a provisional payment against a claim, the Navy must make a preliminary analysis of the contractor's entitlement to compensation and have enough evidence to demonstrate liability for at least the amount of payment. Navy procurement policy provides for provisional payments to contractors only in unusual circumstances when it is found essential for continued contract performance. We believe this policy is unduly restrictive.

It does not allow provisional payments to provide the contractor with a partial payment of claim amounts solely because they are recognized as caused by Navy action. Neither does it allow payments which would save the Government money in financing costs which can accrue as discussed below. Since the Navy claims review process is very time consuming, liberalizing the provisional payment policy when there is adequate evidence of Navy liability would provide contractors with funds without waiting for total claim settlement. This would result in saving the Government the added interest expense and would benefit the contractors.

Negotiating contractor claims on a line-item basis

The Navy generally negotiates final settlements with contractors on the total claimed amount after all analyses are completed. The final settlement amount is reached through a combination of reiteration of previous positions on entitlement, persuasion, and compromise. If the Navy were to negotiate settlements for some individual line items, as their analyses are completed, the contractor could receive payment without waiting for the total claim settlement.

In the past, the Navy's major argument against this approach was that contractors would be more willing to negotiate a complete settlement of the entire claim if it were negotiated on a total cost basis.

However, in those areas where the Navy and the contractor agree on entitlement and on the scope of work performed, we see no reason why both parties should not be able to come to a settlement agreement. For remaining line items involving a great deal of engineering judgment, or where entitlement or scope of work are in question, the Navy could resort to a final lump-sum negotiated settlement.

This approach would have the advantage of narrowing the scope of the unsettled differences between contractors and the Navy. We believe it would also reduce the possibility of contractors combining well-supported portions of a claim

with lesser, or unsupported, portions in a negotiated settlement.

## CONTRACTOR INTEREST CLAIMS

The Armed Services Board of Contract Appeals (ASBCA), and U.S. Court of Claims decisions have allowed contractors to recover certain claimed costs of borrowing, or to recover a rate of return on equity capital, specifically used to finance the cost of performing change work on fixed-price-type contracts entered into prior to July 1, 1970. For fixed-price-type contracts entered into on or after July 1, 1970, Armed Services Procurement Regulation (ASPR 15-205.17) cost principles, which prohibit the recovery of interest, are mandatory. Under these contracts, while interest cannot be allowed as a cost, it can, in theory, be compensated for in the profit element.

As of June 30, 1976, there was $1.6 billion in outstanding and anticipated shipbuilding claims against eight pre-July 1, 1970, shipbuilding contracts not subject to ASPR limitations. At least $48 million of these outstanding claims can be identified as claims for interest. Navy officials expect this figure to rise when the anticipated claims are filed and current claims are revised.

### Guidelines for recovering interest expenses

Interest expenses on borrowed funds have been recoverable to the extent that

--the interest was actually incurred,

--it was reasonable under the circumstances to borrow,

--the "need to borrow" is related to Government actions or inactions,

--there is no specific contract prohibition against the recognition of interest, and

--the interest is traceable to "changed work" through either specific loans or a demonstrated need for additional working capital which, in turn, is supported by specific borrowings. Those specific borrowings may be part of general business borrowings made by a contractor in the course of dealing with banks.

More recently, a landmark ASBCA decision [New York Shipbuilding Company, ASBCA No. 16164, (76-2 BCA-11979)] recognized the use of a contractor's equity capital to finance

change work as a legitimate cost of performance and concluded that the contractor was entitled to some consideration in its profit for this cost. In essence, ASBCA imputed an interest factor to the contractor's cost. This decision has created some doubt within the Navy that the procurement regulation would actually preclude the contractor from recovering interest costs on post July 1, 1970, contracts, if such claims are taken before the ASBCA. The recovery, even if it is called profit, means the Government will have to pay.

Interest expenses accrue at the contractor's borrowing rate from commencement of the changed work to the date of a contracting officer's decision, or Navy settlement agreement. This accrual is reflected in the Navy's analysis and proposed settlement account. Thus, the longer it takes the Navy to analyze a claim, the more interest will accrue on allowable claim amounts.

Despite this accrual of interest, the Navy has not taken steps to reduce its potential liability. Navy's determination of contractor interest entitlement fails to consider potential cost savings that could be achieved by timely analysis and prompt payment of claim amounts.

## Navy could reduce payment of interest accrual by paying claims as the analysis progresses

Liberalizing the Navy's provisional payment policy and negotiating claim items as analyses are completed would put money in the contractor's hands sooner than waiting for a total claims settlement. This prompt payment to contractors would also benefit the Navy by avoiding additional financing cost accrual on the amounts paid. A net savings to the Government can also be shown when the Treasury can borrow funds at a rate below the contractor's rate of accrual.

As an example, on May 6, 1976, Ingalls Shipbuilding Division of Litton Systems, Inc., received a preliminary payment of $15.7 million on account of a claim. The payment was the result of a provisional contract modification based on a preliminary analysis of the claim. It was not made on the basis that the Navy could save interest expenses, but only because the contractor was in financial difficulty. However, the payment will reduce the Navy's interest expense consideration in its final settlement.

If the above payment had not been made and Ingalls were allowed its 8-percent borrowing interest rate from May 6, 1976, to the Navy's projected date for establishing a prenegotiation settlement position of May 31, 1977, about

$1.34 million in interest accural under the claim would have to be considered by the Navy in establishing its prenegotiation position. A net savings to the Government can also be shown as a result of the provisional payment to Ingalls. For example, if we apply the Treasury's 6.382-percent borrowing rate for one month of April 1976 to the provisional payment and over the same period above, the provisional payment would cost the Government $1.07 million. This provisional payment would result in a net savings of $270,000 to the Government.

## CONCLUSIONS

Prompt payment of contractor's claims can be achieved by liberalizing the Navy's provisional payment policy and considering the negotiation of individual claim items, as their analyses are completed. These alternatives would provide the contractor with funds before the total claim settlement is negotiated.

We believe that the Navy's present provisional payment policy is unnecessarily restrictive and can contribute to contractor financial problems and ill feelings toward the Navy.

We believe also that decreasing the amount of time between claim submission and contractor receipt of allowable claim amounts will help foster a more businesslike atmosphere and help alleviate the strained relationship between the Navy and its shipbuilders.

In addition, prompt payment of contractor's claims will stop interest accrual on the amounts and reduce Navy payments to contractors. A net savings to the Government may also be realized because the Government can generally borrow funds at a more favorable interest rate.

## RECOMMENDATIONS

We recommend that the Secretary of the Navy:

--Determine a contractor's entitlement to interest, as early as possible, in the claim analysis process, so that potential cost benefits (interest savings) from prompt payment of claim amounts is considered in any provisional payment decision.

--Revise the provisional payment policy to allow prompt provisional payments, as analysis of individual line items are completed.

--Negotiate and pay for individual line items wherever possible, as analysis of each is completed.

## AGENCY COMMENTS

Navy officials agreed that more liberal use of provisional payments would help alleviate financial problems experienced by contractors in financing Government changes. They also agreed that prompt payment of claim amounts through provisional payments, or negotiating line items, will reduce settlement amounts by stopping additional interest accrual.

Action was taken to adopt our recommendations. On August 12, 1976, the Navy liberalized its provisional payment policy to allow payments to contractors when a legal determination is made that the contractor is entitled to compensation. In addition, in a meeting on December 10, 1976, Navy claims officials told us that they will now consider negotiating settlements on an individual line-item basis for future claims. However, they further stated that it must be recognized that this approach could reduce the contractors' incentive to reach a prompt settlement on the remaining claim items, and thus delay overall resolution of the claim.

## CHAPTER 5

## NAVY IMPROVEMENTS IN SHIP ACQUISITION MANAGEMENT: ARE THEY EFFECTIVE?

We have a continuing interest in Navy programs to improve administration and minimize claims on ship construction programs. We issued reports in 1972 and 1975 which evaluated over 160 separate actions taken by the Navy to improve the management of these programs. In both reports, we concluded that these actions should help reduce future claims. As of January 1977, however, during our current review, the claims backlog reached a total of $2.48 billion. We were concerned that Navy management improvements made in the past few years have not, in fact, been effective in reducing claims.

Navy officials maintain their improvement programs are effective in reducing claims. Most of the current claims backlog is a result of about $900 million in claims filed by Newport News Shipbuilding and Dry Dock Company against six ship construction contracts, all of which were awarded in 1971 or earlier. Navy officials feel this latter fact is important since it was not until after 1971 that many of their management improvements went into effect. Further, these contracts are structured similar to those awarded in the midsixties when the Navy first began experiencing major claims problems. That is, they are fixed-price incentive contracts which have a ceiling price that is only 11 to 35 percent above the target costs and, they do not allow for recovery of escalation costs incurred during periods past the original contract delivery date.

The Navy, therefore, is looking toward a new generation of contracts, including the Patrol Frigate and the Trident contracts to determine the effectiveness of their varied improvement efforts. These two contracts were signed in October 1973 and July 1974, respectively, and represent a significant departure from the Navy's older practices described above. Although the Trident contract for the lead ship is fixed-price incentive, it has a ceiling price that is 52 percent above the target cost to cover unanticipated developmental problems. The Trident contract also contains economic adjustment provisions which the Navy believes are liberal enough to cover the contractors' increases in labor and material costs resulting from inflation.

The Patrol Frigate contract for the lead ship is a cost-reimbursable type contract which practically eliminates the

shipbuilders financial risk. Under a cost-reimbursable contract, claims are largely eliminated even if all causes of claims continue unabated. The incentive to hold down costs is largely removed. For this reason we have recommended judicious use of this type of contract.

In addition to changes in its acquisition techniques, the Navy points to improvements in two management areas, which include control of formal change orders and Government inspection. Regarding formal changes, Navy officials maintain that they now represent only a small percentage of total program costs. Currently, on new construction programs at Newport News Shipbuilding and Dry Dock Company, adjudicated and outstanding formal change orders represent only 4.8 percent of contract prices. Navy officials could not tell what percent changes used to be at Newport News; however, at one other shipyard, changes represented an 8-percent contract price on earlier construction programs.

According to Navy officials, Government inspection problems, as a source of claims, have also been eliminated. They observe that none of the current claims is based on over inspection by the Navy.

At the end of this review, we were prompted to determine if procedural changes had affected the number of potential claims by contractors. We reviewed a contract for tankers awarded in August 1976 and found, as of May 1977, 15 unilaterial changes were made by the Navy. A potential claim for 15 changes has arisen, indicating a need for further improvement in reducing the number of changes, or effecting an expeditious settlement of proposed changes, as recommended in previous reports.

## CONCLUSIONS

We believe that the large backlog of claims outstanding as of January 1977 does not necessarily prove that the Navy is ineffective in current management and administration of its construction programs, especially since the contracts against which most of these claims are filed were awarded 5 or more years ago, and may not have benefited from improved Navy procedures. Although we agree with the Navy that the real test for measuring the effectiveness of its many management and contracting changes may rest with the results obtained from the Trident and Patrol Frigate programs, we believe that the effectiveness of Navy claim prevention improvement actions and related procedures can be determined without waiting for those programs to be

completed. We believe this can be accomplished through a Navy analysis of the causes of claims after each settlement. This would assist in the stabilization and improvement of the working business relationship between the Navy and shipbuilding contractors. We will continue to stay abreast of the progress maintained by these participants in the conduct of the Navy's shipbuilding programs.

## RECOMMENDATIONS

We recommended that the Secretary of the Navy direct that indepth reviews be conducted on settled claims to identify each of the underlying causes of the claim. The Navy should then determine whether the claims prevention actions currently in effect are adequate to prevent recurrence of a similar claim, or whether procedures should be revised or adopted to prevent such recurrences.

## AGENCY COMMENTS

We discussed this matter with the Chairman of the Naval Material Command Claims Board, who agreed with our recommendation. He told us that he plans to start those reviews in the near future, after the staffing by appropriate personnel can be arranged.

## CHAPTER 6

## SCOPE OF REVIEW

We made our review at the Naval Sea Systems Command and the Naval Material Command. Additional information was provided by two selected Supervisors of Shipbuilding and contractors. We examined the (1) Navy's procedures for settling claims, (2) documentation provided by contractors in their claim submissions, and (3) documentation finally used by the Navy to reach a claim settlement position. We interviewed cognizant Navy officials and representatives of certain shipbuilding companies which submitted claims.

APPENDIX I

## COMPARISON OF PROPOSED AND ACTUAL PROFIT OR LOSS ON CONTRACTS UNDER WHICH CLAIMS WERE FILED BY FOUR CONTRACTORS

(all dollars are in millions)

| Contractor and ship program | Contract number | Contract price | Contractor costs incurred | Profit (loss) before claim | Claim amount | | Proposed profit (loss) based on submitted claims | | Actual profit (loss) based on settled claims | | Original anticipated profit |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Submitted | Settled | Amount | Percent | Amount | Percent | |
| Avondale Shipyards, Inc.: | | | | | | | | | | | |
| Destroyer escorts | Nobs-4784 | $ 87.9 | $106.5 | -$18.7 | $ 47.1 | $17.0 | $ 28.5 | 26.8 | $-1.6 | -- | 7% |
| | N00024-67-0220 | 262.5 | 312.1 | -49.5 | 122.0 | 63.0 | 72.4 | 23.2 | 13.4 | - | 7% |
| | | 350.4 | 418.6 | -68.2 | 169.1 | 80.0 | 100.9 | 24.1 | 11.8 | 2.8 | 7% |
| Bethlehem Steel Corporation Sparrows Point Yard: Ammunition ships | Nobs-4998 | 50.4 | 76.3 | -25.8 | 49.6 | 17.0 | 23.7 | 31.0 | -8.9 | Loss | 0% |
| General Dynamics Corporation Quincy Shipbuilding Division: Submarine tenders | Nobs-4901 and 36(A) | 81.4 | 156.9 | -75.4 | 69.7 | 33.0 | -5.7 | Loss | -42.5 | Loss | 3 to 7% |
| Newport News Shipbuilding and Dry Dock Company: | | | | | | | | | | | |
| Amphibious cargo ships | Nobs-4921 | 82.1 | 104.0 | -21.9 | 24.0 | - | 2.1 | 2.0 | - | - | 0% |
| | and 78(A) | 23.3 | 24.5 | -1.2 | 5.1 | - | 3.9 | 15.7 | - | - | 4.8% |
| | | $105.4 | $128.5 | -$23.1 | $ 29.1 | $14.4 | $ 6.0 | 4.7 | $-8.7 | Loss | |

APPENDIX II

## A SUMMARY OF THE NAVY CLAIMS EVALUATION AND SETTLEMENT PROCESS

### DEFINITION OF A CLAIM

Section 1-401.55 of the Navy Procurement Directives defines the term "claim" as a request for a contract adjustment, involving to a significant extent, "constructive change"--i.e., a change based on Government conduct, including actions or inactions which is not a formal written change order, but has the effect of requiring the contractor to perform work different from, or in addition to, that prescribed by the terms of the contract.

The term "Request for Equitable Adjustment" has been used recently to define contractors' demands for increases in contract prices based on events which allegedly fall within the coverage of express contract provisions, e.g., formal written change orders, escalation, or late or defective Government-furnished property, or information. Even though requests for equitable adjustment are the result of formal changes, the Navy evaluates them under the same procedures as "constructive changes." The Navy does this because of the large dollar amounts and complex factual nature of the requests.

For purposes of this report, the term "claim" means a contractor's demand for increased compensation because of an alleged constructive change, an express contract clause, or both. This usage is consistent with the Navy's usage.

### PROCESSING CLAIMS ($1 MILLION OR OVER)

Upon receipt of a shipbuilding claim, the Navy performs a preliminary review to determine its completeness and acceptability, considering criteria established by the regulations. The principal regulations are Navy Procurement Directive Section 1-401.55, the "Truth in Negotiations Act" requirements of the Armed Services Procurement Regulation (ASPR) Section 3-807.3, and the ASPR Manual for Contract Pricing. Based on this preliminary review, the Navy makes a recommendation/decision to either reject the claim or accept and process it.

If the claim is accepted, a multidisciplined claim settlement team is established, consisting of a contracting officer (team manager), engineer, counsel, and Defense Contract Audit Agency (DCAA) auditor. The claim settlement

team reviews the claim and prepares a claim settlement plan. The plan includes:

--A brief summary of each claim item and how the claim item can be classified (lead-yard/follow-yard drawings, delay, defective specifications, disruption, etc.).

--The elements of proof required to support entitlement for each claim item.

--An opinion as to the data necessary to support legal entitlement and amount, and the extent to which the contractor has presented this data.

--A claim processing schedule showing the estimated completion date for each major event.

--An outline of the proposed data filing system to be used during claim analysis and evaluation and any subsequent litigation.

The claim team then investigates the claim to develop the relevant facts, and has the right to request, receive, and inspect any and all relevant data and records of the contractor. From this factual investigation, the claim team develops preliminary documentation of the Navy's position consisting of:

1. A preliminary technical analysis report prepared by the team engineer and/or technical analysts with the advice of other team members. It contains a factual recitation of the claim and the engineering evaluation and analysis of the claim's technical merits.

2. A preliminary legal memorandum prepared by the team counsel, and based on the preliminary technical analysis report. This memorandum points out areas requiring further clarification and furnishes guidance on the validity of the claim issues.

3. Audit assistance as necessary in the evaluation of facts and verification of costs.

Preliminary documentation receives a Headquarter review by the Contract Administration Division, of the Naval Sea Systems Command and the Navy Office of Counsel, which provide their comments to the team manager for preparing the final technical analysis report.

Final claim team documentation consists of a final technical analysis report, a final legal memorandum, and a DCAA audit report. The team engineer prepares the final technical analysis report and considers all team members' and Headquarters' review comments. Preliminary technical analysis report positions can be revised upward to reflect a more objective position if the preliminary analysis is judged to be unrealistically low.

The final legal memorandum contains analyses of the applicability and adequacy of the contractor's legal theories of Government liability. It also evaluates the presence and adequacy of evidentiary facts satisfying the elements of proof required by the contractor's legal theories. In addition, the legal memorandum assigns litigative risk to certain claim elements, based on analysis of relevant case law.

Determination of litigative risk

The term "litigative risk" is used generally to represent a legal assessment of areas where the Navy counsel feels weaknesses exist in the Navy's position. Should the claim be appealed to the ASBCA or the Court of Claims, these weaknesses could result in additional compensation to the contractor above the technical/audit positions established.

Litigative risk is expressed in dollars and includes two considerations: actual litigative risk, where the Navy questions the contractor's right (entitlement) to compensation, and a jury verdict evaluation, where the amount (quantum) of compensation is questioned.

In questions of entitlement, litigative risk is usually computed by taking a percentage of the disputed item ranging from zero to 100 percent. For example, where there are no facts or legal precedents which could operate to allow the contractor to prevail, a zero-percent litigative risk would be assigned. Conversely, where the Navy is certain the contractor would prevail, a 100-percent litigative risk would be assigned.

Questions of quantum are often resolved by the ASBCA or Court of Claims, using the jury verdict technique. They resort to a jury verdict when they are not convinced that either the contractor's or the Navy's position is correct and that the facts in the record do not permit a precise calculation of increased costs. In such cases the ASBCA or Court of Claims analyzes documentation supporting the opposing positions and hears oral arguments of both parties. The resulting decision bridges the difference between the two positions by some combination of percentages. Navy counsel

attempts to estimate the outcome of a jury verdict situation and includes this in the litigative risk assessment.

Litigative risk amounts are not automatically allowed to the contractor, but are considered in establishing a pre-negotiation ceiling. It provides negotiating discretion by justifying amounts in excess of the Navy technical/audit positions.

The Advisory Audit Report sets forth the results of DCAA auditors' reviews and analyses of cost data submitted as part of the pricing proposal (claim) and review of the contractor's accounting system, estimating methods, and other related matters. It is prepared using the final or preliminary technical analysis report, if available.

Based on the technical analysis report, the legal memorandum, and the audit report, a pre-negotiation position range is developed and presented for appropriate review. Claims with a proposed settlement value of over $1 million are reviewed by the Naval Sea Systems Command Contract Administration Division and an established Claims Board. Final approval, however, must be given by the Naval Sea Systems Command Deputy Commander for Contracts. Claims with a proposed settlement value below $1 million are adjudicated by the Supervisors of Shipbuilding.

Prior to settlement negotiations, the business aspects of proposed contractual actions in the pre-negotiation position range must be approved by the Chief of Naval Material. This approval is called the Pre-Negotiation Business Clearance. Upon completion of negotiations, a Post-Negotiation Business Clearance is also required. These business clearances set forth all significant details of the proposed contract negotiation and of the negotiation results obtained.

The Post-Negotiation Business Clearance is presented for review and approval according to the following criteria:

1. Claims with a proposed settlement value of between $1 million and $10 million are reviewed by the Naval Sea Systems Command Contract Administration Division and Claims Board. Additionally, any proposed settlement in excess of $5 million is summarized and informally reviewed by the Chief of Naval Material and the Assistant Secretary of the Navy (Installations and Logistics). Final approval is made by the Naval Sea Systems Command Deputy Commander for Contracts.

2. Claims with a proposed settlement value of over $10 million are also reviewed by the Contract Administration Division and the Naval Sea Systems Command Deputy Commander for Contracts and the Naval Sea Systems Command Claims Board. The proposal and their recommendations are then forwarded to the Chairman, Naval Material Command Claims Board for further review. Final approval is given by the Assistant Secretary of the Navy (Installations and Logistics).

Final disposition of the claim is made by issuing an approved contract modification for a negotiated settlement, or a contracting officer's final decision, if an agreement is not reached.

Contractors can appeal their claims or contracting officer's decisions to the Armed Services Board of Contract Appeals (ASBCA) for questions of entitlement or quantum (amount) determinations. Settlement negotiations can and often do continue while the claims are under appeal.

## SPECIAL NAVY CLAIMS SETTLEMENT BOARD ESTABLISHED FOR NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY CLAIMS

In July 1976, the Navy established a Navy Claims Settlement Board to resolve claims submitted by the Newport News Shipbuilding and Dry Dock Company. It consisted of three full-time members, a contracting officer, a legal representative, and a business representative. The Board was intended to operate as an independent claims settlement authority free from outside pressures, influence, or unsolicited advice. The contracting officer, as chairman, with the advice and assistance of other Board members, would conduct negotiations with the contractor and upon settlement, execute the necessary contractual modifications. If settlements were not reached, the chairman would render final contracting officer decisions pursuant to the "disputes" clauses of the pertinent contracts. Later, we learned that one claim was settled in February 1977 by this Board and that the Navy plans to settle all remaining major claims by the end of 1977.

## SETTLEMENTS

The dollar value of settlements, which have averaged about 40 percent of the contractors claim, has led many to speculate, based on that fact alone, that claims are inflated by the shipbuilders. While we found in this review that some claims were, in part, overstated, we believe it is

APPENDIX II

incorrect to conclude that an acceptance of a settled amount below the claimed amount indicates that claims are inflated or establishes wrongdoing.

While the contracts discussed in this report were firm-fixed-price, most contracts for naval ships are now fixed-priced incentive. Under the latter type, a ceiling price is provided which is greater than the negotiated target cost, plus profit. This is done to provide for additional unanticipated cost and to limit the Government's obligation to pay.

In addition, when a claim is filed by a contractor under this type of contract it is expressed in terms of a new higher ceiling price. However, the contractor and the Navy settle the claim in terms of the claimed-target-cost-plus profit--a lower figure. Therefore, representations of settlements that compare the claimed amount at ceiling with the settlement amount at target cost, plus profit is misleading. The following illustration is given to demonstrate this point.

For example, suppose a contractor submits a claim with a target-cost-plus profit of $10 million and a ceiling price of $12 million. Let us further assume the Government and the contractor settle the claim midway through contract performance for a target-cost-plus profit of $8 million, and a ceiling price of $10 million. Under present representations of settlements, it could be reported as comparing the $8 million negotiated-target-cost-plus profit with the $12 million claimed ceiling price or a 66-percent settlement of the claimed amount. It could also be reported as 80 percent settlement by comparing the $8 million negotiated-target-cost-plus profit with the $10 million claimed target-cost-plus profit which is a more reasonable representation of the settlement by comparing figures of a similar nature.

It should be recognized that the foregoing example deals only with claims settled during the course of the contract which requires an estimate of future cost. Other situations take place when the claim is settled after, or near, contract completion.

APPENDIX III

OGDEN TRANSPORTATION CORPORATION
277 PARK AVENUE
NEW YORK, N. Y. 10017
(212) 754-4044

M. LEE RICE
PRESIDENT

March 23, 1977

Mr. R.W. Gutmann, Director
United States General Accounting Office
Procurement and Systems Acquisition Division
Washington, D.C. 20548

Dear Mr. Gutmann:

Your letter of February 15, 1977 addressed to Ralph E. Ablon, Chairman of the Board and President of Ogden Corporation, has been studied and reviewed by the officers of Ogden Corporation and Avondale Shipyards, Inc. who are familiar with this subject. I am enclosing a letter from Edwin Hartzman, President of Avondale, discussing the protracted relationship with the Navy covering the construction of twenty-seven destroyer escorts between 1964 and 1974. Ogden completely concurs in Mr. Hartzman's letter.

I am submitting this letter to supplement Mr. Hartzman and explain why Ogden accepted the 1975 settlement even though we believe (and continue to believe) that it did not fairly reflect the law and facts and is substantially less than the result Avondale could have achieved in litigation. Avondale represents a high percentage of Ogden's asset commitment because shipbuilding is an asset intensive business.

The Navy claim was so significant in Ogden's context that our auditors continuously qualified their opinion on our consolidated financial statements from 1968 through 1974 (the last year prior to the settlement), except for 1970. The 1970 opinion was not qualified because shortly before these statements were released in early 1971, Avondale was led to believe that it had reached a settlement with the Navy requiring only routine implementation. Our auditors conferred with Navy personnel who confirmed this understanding. Thereafter, due to a shift in the Navy bureaucracy, the settlement was not implemented, nearly four additional years of negotiations ensued, and the

APPENDIX III



qualification was restored. This "on again off again" qualification created confusion and suspicion in the financial community. For many years the value of Ogden's securities was depressed by the Navy claim overhang. Moreover, as the job progressed Avondale incurred increasing cash flow deficits so that by the time the final settlement was reached in 1975 they were approaching $28,000,000. As these deficits mounted, commercial interest rates soared. Navy representatives questioned the government's responsibility for interest, but in the real world interest must be paid to lenders and evaluated in management's decisions. While we believe that Ogden and Avondale are prudently managed and financed, there is a limit to which a publicly held company can or should invest its stockholders' funds in a financial show down with the United States Government.

We believe that some of the Navy personnel fully understood the adverse market impact and the limitations on our financial capability and felt that they should capitalize on these factors to drive a hard bargain for the government. We question whether this is fair. It is no way to develop a sound relationship with a responsible supplier. It seems particularly inappropriate since no one seriously questioned that Avondale was entitled to significant amounts due to massive Navy change orders and constructive change orders after the contracts were awarded. It explains why Avondale, like many other potential government suppliers, would prefer to deal with almost any commercial customer rather than the ritualistic, leverage prone and constantly changing Navy.

We appreciate this opportunity to present our position.

Very truly yours,

M. Lee Rice

M. Lee Rice

MLR:sf

**AVONDALE SHIPYARDS, INC.**

P. O. BOX 50280. NEW ORLEANS, LA. 70150 • PHONE: 776-2121 • AREA CODE 504
WESTERN UNION TELEX:
ENGINEERING AVONENG 58-245
PURCHASING AVONPUR 58-246

March 23, 1977

Mr. R. W. Gutmann
Director
Procurement and Systems
Acquisition Division
U. S. General Accounting Office
Washington, D.C. 20543

Subject: Draft Report on Shipbuilders' Claims - DE 1052 Class Claims by Avondale Shipyards, Inc.

Dear Mr. Gutmann:

This will respond to your letter dated February 15, 1977, enclosing portions of a draft report entitled, "Shipbuilders' Claims -- Problems and Solutions", and requesting our review and comment. We have carefully reviewed the materials which you provided, and in connection with our review we have analyzed the principal documents which were generated during the negotiation and settlement of our DE 1052 Class destroyer escort claims.

I.

We must state at the outset that it is exceedingly difficult to respond appropriately to many of the statements contained in your draft, since such statements are very summary and lack any reference to sources either in the form of documents or individuals. In many cases, the statements are, to our certain knowledge, entirely untrue or are such significant distortions of fact as to imply motives on our part which the record indicates did not exist. It would appear to us that where serious charges of the type which your report appears to make are to be leveled in connection with a matter as complex and difficult as were the subject claims, it would behoove the investigators

APPENDIX III



to perform a more thorough analysis, including the review of documents attributed to the accused and perhaps the interviewing of key personnel of the accused. Short of doing this, you are producing a result which suggests guilt or culpability where your sources of information are nowhere apparent and are plainly contrary to our own records. Your report states that your review was performed at our shipyard. Either the statement is untrue, or you were present in our yard without our knowledge and consent. In any event, it seems clear that you made no effort whatsoever to substantiate any portion of your report through personnel of our company or reference to our records. Since your report implies our participation, consent or knowledge of your operations "at Avondale Shipyards", it is deceptive and in error.

If it is your intention to publish a report on this subject for Congress or the public, it would seem appropriate that its factual elements be reasonably truthful and accurate and that its conclusions and recommendations logically follow from factually established assumptions. Unhappily, the present draft contains none of these elements.

Apart from the rather meager specifics which you include in your report, there appears to be an underlying assumption that the shipbuilding claims involved could have been treated quite systematically and expeditiously but for the acts of this company. The principal emphasis of the report is the allegation of delays by Avondale and the allegedly intentional furnishing of incomplete and inaccurate data by the company to the Navy. A more careful inquiry into the matter would have revealed that these allegations are wholly contrary to fact. So that you may understand just how erroneous your allegations and conclusions are, we are setting forth the most relevant background facts, and we earnestly request that your report be modified materially so that it will not suggest a lopsided, unfair and untrue portrayal of our company's position in the matter.

II.

Avondale performed two contracts which gave rise to the subject claims. The first contract was awarded in 1964 and called for the construction of seven ships. The second contract was awarded in 1966 and called for the construction of twenty ships. In 1964, when Avondale received its first contract, it was one of four shipyards which received DE 1052 Class contracts. The other three were Todd-Los Angeles, Todd-Seattle, and Lockheed. At that time, Todd-Seattle was designated

the lead yard and, among its other contractual duties, assumed responsibility from the Navy for the completion of the ship design contract which was then being performed by Gibbs and Cox. An underlying assumption in this first Avondale contract was that "lead yard plans" would timely be made available to Avondale by Todd-Seattle.

Because of the derelictions and mismanagement of the design effort by the Navy, and because of equally incompetent management of Government furnished information, materials and changes by the Navy, the Todd-Seattle lead yard plans were not made available on a timely basis and were substantially incomplete and defective when finally delivered. The record in this program established beyond peradventure that it was one of the most poorly managed and implemented shipbuilding programs in the Navy's history. Thus, in addition to the problems inherent in the design when made available, changes of immense scope and having a thoroughly delaying and disorienting effect were made virtually throughout the life of the program.

Early in 1969 Avondale presented a claim to the Navy covering both "directed" changes ordered by the Navy and constructive changes, delays, and disruptions resulting from the Navy's conduct in the management of the program. For the succeeding two years Avondale conducted extensive negotiations with the Navy with a view to settling these claims. Almost concurrently with Avondale's presentation of claims, the other shipyards involved in the program (Lockheed, Todd-Seattle, and Todd-Los Angeles) also presented similar claims.

It is fair to state that the documentation generated by Avondale in the negotiations conducted between 1969 and December of 1970 and the format for the presentation of the claim represented the information in kind and detail which the Navy desired. In fact, much of this time was consumed in providing a structure and detail for the claim which comported quite specifically to the Navy's desires.

In 1970 the Navy settled the Todd claims. In December of 1970 a settlement in the amount of $73.5 million was reached between Avondale and the Navy. It is relevant to point out that this settlement was wholly satisfactory to the Navy personnel involved in its negotiation, including Admiral Sonenshein, then Commander of NavSea. However, such settlement represented a considerable risk for Avondale, since the settlement figure did not cover Avondale's probable costs at completion and since approximately four years of work remained in the performance of the contract. So that it is quite clear, we note again that this claim was, in form and detail, specifically what the Navy desired. Both the format of the claim and the kind and detail of documentation had been specified by the Navy and wholly satisfied by the company.

APPENDIX III



A similar settlement was reached between the Navy and Lockheed on claims which again were very much akin to those of Avondale.

As you may know, "higher authority" in the Navy chose to abrogate both the Avondale settlement and the Lockheed settlement. This act of manifest bad faith compelled Avondale to pursue its claims for an additional 4½ years before settlement was again reached. In the case of Lockheed, as you may know, the Navy's abrogation of its settlement was summarily reversed by the Armed Services Board of Contract Appeals in Lockheed Shipbuilding & Construction Co., ASBCA No. 18460, 75-BCA ¶ 11566. 1/

After the Navy's abrogation of its settlement in January of 1971, the Navy compelled Avondale to reformat and resubmit its claims in a form which, although different, was hardly better suited to negotiation and settlement. The Navy subsequently attempted to obtain approval of a settlement of such resubmitted claims within its own confused and disorganized operations, but failed.

Finally, in the Spring of 1972, in an attempt to obtain a settlement and avoid litigation, Avondale once again agreed to restructure and resubmit its claims. The procedure then agreed upon embodied the submission of a "pilot" claim which would be used as a model for reaching agreement on principal and methods. This pilot claim item was submitted in November of 1972 and was followed in 1973 and 1974 by the remainder of Avondale's claims. Avondale's agreement with the Navy was that the claim items would be examined and negotiated individually on their merits and amounts. In this process there was to be a free and open exchange of information by both parties. This was particularly important since the Navy had already dealt with virtually the same claims and facts in connection with the claims of the other three shipyards participating in the DE 1052 Class program.

1/ The Board's initial decision and its decision on the motion for reconsideration are most instructive and informative on the subject of the Navy's gross mishandling of the DE 1052 Class claims. It should be noted that the Navy's confusion, indecision and double-dealing, which are so vividly described in the Board's decisions, were being repeated, practically verbatim, by the Navy in its dealings at the same time with Avondale.

The Navy never kept its agreements regarding the resubmission and negotiation of these claims. Rather than considering the claims on their merits and negotiating the principal fact and cost issues, the Navy adamantly refused to conduct any negotiation whatsoever. The Navy insisted that the claims be presented subject to never ending waves of demands for additional and often conflicting and useless documentation, followed only by "fact finding" sessions in which "nit picking" and often irrelevant details were discussed. The Navy, in this entire period, consistently refused to commit itself to any positions on factual, cost or legal matters and ultimately took the position that it would not conduct any negotiations on the elements of the claims but would ultimately make a "bottom line" settlement offer.

Worse yet, although the Navy demanded every shred of documentation available (much of which appears never even to have been read), the Navy at all times refused to provide to Avondale any data which the Navy had addressing the subject matter of the claims.

Throughout this period (from 1972 through 1974) the Navy's principal problem appears to have been that it was incapable of marshalling, for purposes of review and negotiation of the claims, a competent staff adequately trained and experienced and in sufficient numbers to conduct the overblown process which the Navy had designed for itself. This problem was compounded incessantly by turnovers in what little staff was made available and by constant changes in direction, apparently emanating from "higher authority".

As you may know, Navy shipbuilding contracts expressly provide that the Navy will finance the construction of the ships. As you may also know, this is not simply the normal progress payment agreement which exists for most Government contracts, but rather embodies special provisions which take into account the very great expense and long duration of shipbuilding contracts. 2/ Avondale entered into the

2/ See, in this connection, NavShips Standard Form General Provisions 7, "Payments" (April, 1961); see also, Department of the Navy Task Group Report, July 31, 1972, and NavShips Memorandum for the Comptroller of the Navy, Ser. 776-022, May 23, 1972. As you may also know, the Armed Services Procurement Regulation itself explicitly mandates that claims be considered and paid expeditiously, including provisional payments, so that contractors are not forced to finance Department of Defense work. ASPR 1-314(6); ASPR 1-314(e); ASPR E-202, E-511.6 and E-576. See also Comp. Gen. Decis. B-151113, May 21, 1963.

two subject contracts on the reasonable assumption that it would not have to commit substantial amounts of capital to financing Navy warships. Nevertheless, by 1968 Avondale was obliged to finance such work, and such financing continued until the settlement of the claims in June of 1975. This financing of the Navy's shipbuilding work was necessitated by the Navy's own confusion and delays in disposing of the claims. Moreover, there is some reason to believe that compelling Avondale to finance the work was deliberate on the Navy's part as a means to relieve the very serious appropriations deficiencies which the Navy then was experiencing, and apparently continues to experience. It is relevant to note that by December of 1974, Avondale's cost of financing this work alone totaled more than $15 million.

It is true that during this protracted period the Navy made provisional payments against the Avondale claims, such provisional payments totaling approximately $48 million. The record, however, will clearly reveal that such provisional payments were made only because Avondale's picture became so desperate that it was compelled to threaten both the discontinuation of performance and a literal refusal to deliver the ships.

Avondale's total claims as resubmitted totaled $169 million. As you know, these claims were ultimately settled for $80 million, an amount representing slightly less than half of the amount claimed. From this fact alone, you appear to reach some presumption that the claim was overstated. A more careful inquiry on your part would have disclosed that the settlement at the low figure resulted not from an initial overstatement of the claim, but from the utter impossibility of pursuing the claim for another three to four years in litigation with a record which had then become in substantial measure old and stale. You correctly perceive perhaps the very great inherent difficulty in prosecuting shipbuilding claims, both for the Navy and shipbuilders. Such difficulty is amplified when litigation becomes necessary many years after the occurrence of the controlling facts. This fact would have been apparent to you had you reviewed as examples litigation such as that conducted in Litton Systems, Inc., Ingalls Shipbuilding Division, ASBCA No. 17717, 76-1 BCA ¶ 11851; Lockheed Shipbuilding Construction Co., supra; and New York Shipbuilding Co., ASBCA No. 16164, 76-2 BCA ¶ 11979.

It would seem that your report to Congress would be considerably more useful were it to contain at least some elements of the foregoing background which one might reasonably presume bear on Avondale's claims. To reach the simplistic and wholly erroneous conclusion that Avondale's claims were "inflated", were developed by Avondale, and were not properly supported, without any of the foregoing background is wholly erroneous and a gross distortion of the facts. Such an erroneous report will hardly result in the solution to Government management problems nor assist Congress in developing necessary legislation.

III.

We wish to address specifically those portions of your draft report which you have seen fit to provide to us and in which there appear accusations which are in error.

In chapter 2, page 4 of your draft, you set forth certain requirements of Navy Procurement Directives and the Navy's Ship Acquisition and Contract Administration Manual (SACAM) which you apparently cite as a basis for the correct composition of a shipbuilding claim. Interestingly enough, the relevant portions of the documents which you cite did not even exist when Avondale's claims were first presented to the Navy and did not come into being until approximately 1972. Furthermore, neither the Directives nor the SACAM is incorporated in Avondale's contract or is required to be used by Avondale as a basis for the composition and presentation of shipbuilding claims. You may be interested to know that neither of these documents has legal or contractual effect even under current Navy shipbuilding contracts.

The Navy Procurement Directives hardly provide any meaningful guidance in the preparation and presentation of shipbuilding claims. They state obvious platitudes and their generation by the Navy in the first place appears more to have been a means to assure that the Navy could cover up its operative failures in the disposition of shipbuilding claims than as a means to assure equitable and expedited treatment.

The SACAM again states obvious and highly idealistic principles for the presentation of a shipbuilding claim. As you seem to acknowledge, the Manual appears to address the problems and impossibilities of shipbuilding claims and not the solutions to problems of preparation

and presentation. It is well known and accepted that the conditions to which you refer for the preparation and presentation of a "disruption" claim are impossible for a shipbuilder to develop insofar as they would require a kind of record keeping devoted to the composition of claims and not to the construction of ships. 3/ We believe it is fair to state that of the several billions of dollars in shipbuilding claims which the Navy has negotiated or litigated over the last several years, none have met the criteria which you cite.

At chapter 2, page 5 of your report, you correctly note in this connection that contractors are unable to account with "mathematical certainty" for all delay and disruption costs attributable to Government actions. A more careful investigation on your part, including analysis of such claims and interviewing of experts, both within the Government and in industry, would have revealed that the keeping of records supporting mathematical certainty in connection with shipbuilding construction work involving miles of facilities and thousands of persons is beyond reasonable expectation and not required in proof of a claim. 4/

Moreover, you are absolutely in error in your assertion that the Armed Services Board of Contract Appeals and the United States Court of Claims have "concluded that the cause of disruption/delay must be established with certainty". In fact, that the opposite is true has been established without doubt. Litton Systems, Inc., Ingalls Shipbuilding Division, supra, and General Dynamics Corp., ASBCA No. 13885, 73-2 BCA ¶ 10160.

3/ See, Fishbach & Moore International Corp., ASBCA No. 18146, 77-1 BCA at ¶ 59,231. This problem was clearly recognized by Navy legal personnel even at the time our claim was presented. See, Hishe, The Recognition of Delay, Disruption and Acceleration in Changed Work, 6 Pub. Cont. L. J. 152 (May, 1973). (Mr. Hishe was the Assistant to the General Counsel for the Navy.)

4/ This fact was clearly determined by the Armed Services Board over the Navy's vigorous objections in Fishbach & Moore International Corp., supra, at ¶ 59,231.

APPENDIX III



You are more nearly correct when you state, at page 5, that the accurate ascertainment of delay and disruption requires "reasoned engineering, business and legal judgment and analysis to arrive at estimates". This is precisely the approach which was taken in our DE 1052 Class claims. Our records fail to disclose that the approach or its product was criticized as being "deficient". Quite the contrary is true. Although the Navy clearly disagreed with our results, the approach itself naturally lends to a high degree of value judgment wherein parties can differ.

You also correctly note, at the bottom of page 5 and the top of page 6, that the memory of shipyard personnel is employed rather heavily in connection with the preparation of the delay and disruption portion of the claims. Again, this is the result of the fact that detailed record keeping with regard to delay and disruption would consume more man hours than the productive work itself and would also require the contractor to know in advance that significant delay and disruption will be encountered in the future. Not even the Navy has suggested that there is some means to gain this kind of 20-20 foresight.

By the time the claims were restructured for the third time at the Navy's behest in 1972, it was becoming increasingly difficult to draw on current recollections of personnel. Many of the important operative facts were by then five years old. As you can see, however, this was hardly the fault of Avondale.

It is most relevant to point out that the Navy, in formulating its own version of delay and disruption, also employs the memory of its own personnel or, worse, attempts merely to second guess the recollections of the shipbuilders' personnel. This kind of critiquing was employed by the Navy in the Avondale claim. Not only did it not enhance negotiations, but it was performed by untrained and inexperienced Navy personnel who had little means to analyze professionally a delay and disruption claim.

We are mystified, under the foregoing circumstances, at your conclusion:

> Thus the contractors have been lax in presenting specific documentation tying in Government actions with delay and disruption costs claimed. (Emphasis supplied.)

APPENDIX III



As we commented earlier, your draft report is so lacking in detail and precision that it becomes difficult to comment realistically on the conclusions you have reached. This particular conclusion is especially perplexing, since it lacks a factual or legal predicate and is unlikely to have been reached by one actually familiar with the formulation, presentation, negotiation and settlement of shipbuilding claims.

We note your comment in chapter 2, page 6, that contractors do not believe the Navy Directives and Manual are legally binding. As we have noted above, your statement is quite accurate. Avondale does not believe the Directives and Manual to be binding. We, of course, attempt to follow the Directives and Manual in order to be cooperative in the claims process. However, where the Directives and Manual suggest procedures which are impractical or contrary to our contractual rights, we can hardly be expected to adopt such procedures, and you are correct in assuming that we have refused and will refuse to do so.

We note also at page 6 of your report your findings that the Navy had to request data needed to perform claims analysis. In our own case, our claims totaled almost $170 million and encompassed literally dozens of individual claim items and sub-items. The claims resulted, directly and indirectly, from the issuance of more than 1500 change orders and hundreds of constructive changes by the Navy. By the third iteration of the claims at the Navy's request, Avondale generated 63 volumes and 12500 pages of formal documentation, to say nothing of the tens of thousands of pages of documentation which was informally made available. In all three instances in which the claim was presented, we attempted to comply fully with the Navy's requests not only as to format but level of detail as well. Notwithstanding these efforts, however, it is not unnatural that in so large and complex a set of claims the recipient of the claim would, upon analysis, require additional detail. Under the circumstances, we do not understand why you make a particular and accusatory point of this matter.

Furthermore, as we have pointed out above, part of the problem in achieving an acceptable level of detail has been the Navy's constantly changing requirements. We believe this to be, in part, the result of the use of inexperienced and untrained personnel. 5/ Additionally,

5/ This problem (in dealing with the Navy on shipbuilding claims) was specifically addressed by the Armed Services Board on a number of occasions in recent years and most recently in Litton Systems, Inc., Ingalls Shipbuilding Division, supra. See also, Southwest Walding & Mfg. Co., ASBCA No. 16833, 72-1 BCA ¶ 9310.

as you may know, the Navy has been subjected to substantial criticism with regard to its handling of shipbuilding claims and we must suggest that its constant requests for additional details are, in part at least, an effort to insure against criticism by developing a copious record. 6/

You also allege that the Navy was provided with inaccurate data, or encountered delays in obtaining requested data, or had to reconstruct data which should have been provided by the contractor. If these vague and general references were intended to apply to Avondale, we must state that they are in error. Our records to not disclose that inaccurate data was provided to the Navy. Your report (or at least so much of it as you provided to us) fails to disclose that any of the data which we provided was inaccurate.

With regard to the problem of delays in obtaining requested data, we again point out that our claims were first presented in 1969 and were not settled by the Navy for 5½ years. During most of this time we were obliged to finance substantial amounts of Navy shipbuilding work. It would seem improbable from these facts alone that we would knowingly delay in providing the Navy whatever data was necessary to effect settlement. Indeed, the record discloses otherwise. As we have stated, we provided such data to support at least three separate settlement efforts undertaken by the Navy and in each instance such data was provided expeditiously. As you can readily see, the Navy's record for expediting negotiation and settlement reflects inordinate delays. In our particular case, some of the delay interposed by the Navy resulted from the lack of adequate personnel properly trained and experienced to review the data which was presented. A careful analysis of the record in our case would have disclosed this fact to you and would also have disclosed the many complaints regarding this fact which we made to the Navy during the 5½ year period.

6/ A great deal of this criticism actually resulted from the Todd DE 1052 Class settlement. Whether or not the criticism was justified, it resulted in extensive delays in the settlement of the remaining claims on this program, and Avondale, not the Navy, was the victim.

APPENDIX III



Your statement that the Navy had to reconstruct what should have been provided by the contractor similarly does not appear to bear on our case. Our records fail to disclose that the Navy performed any such task and if, indeed, the Navy did perform such a task, its failure to disclose its results to us must be considered a serious breach of faith in the negotiation undertaking.

It is true that the Navy performed considerable analysis on the data which we provided, and much discussion was had over such controversial subjects as calculation of delay and the formulation of delay and disruption costs. For you to assume that the Navy would not have to perform such analytical work on a contractor claim is to suggest that there is no adversary relationship between the Navy and the shipbuilder in the presentation and negotiation of hundreds of millions of dollars in claims. Such a position would be, to say the least, naive.

You have made a specific allegation (albeit rather generally stated) that our claim was "inflated". This allegation is false in all respects. To the very minor extent that you have included any specifics to support the allegation, such specifics are seriously misstated and constitute a gross misinterpretation of the facts.

It is true that the two contracts had an original value of $350.4 million. The incurred costs, however, were not $418.6 million, but approximately $451 million, not including extensive in house management and claims team costs incurred over the 5½ years of negotiations. The $80 million settlement resulted in a loss of $21 million for ten years of work (1964 contract to 1974 delivery of the twenty-seventh ship).

Among the many things which your very cursory review has failed to take into consideration was the enormous cost of financing which was incurred by the shipbuilder. As you may not realize, this cost is recoverable from the Government in shipbuilding claims. Litton Systems, Inc., Ingalls Shipbuilding Division, supra; New York Shipbuilding Co., supra.

In addition, the company incurred enormous amounts of "unabsorbed" indirect costs which, because of the delays in the DE 1052 work, had to be booked to other work. Naturally, however, these costs could not be recovered under such other work and are properly considered part of the cost (and loss) incurred under the DE 1052 contracts.

APPENDIX III



Another fact of which you may not be aware is that, but for the acts of the Navy, the performance of the two contracts would have resulted in significant profits to the company. Thus, not only would the company have realized the 7% bid profit, but also, as a result of significant savings in material purchases against the Navy's "fixed" escalation provision, substantial additional profits would have resulted. Furthermore, the company developed fabrication processes during performance which resulted in sizable labor cost reductions. While we are aware that the realization of significant losses on Navy shipbuilding contracts is typical, this company feels no particular obligation to finance the Navy's shipbuilding program. Further inquiry by you of the Navy will disclose that the ships which we built were among the best which the Navy obtained. Such inquiry will also disclose that, notwithstanding the enormous problems, which were not of our making, our work was most expeditiously performed. Finally, such inquiry will also disclose that, notwithstanding your allegations, the Avondale ships were completed at the least cost to the Government, and of the four shipyards performing under this program, our claims were, per ship, the lowest.

At chapter 2, page 7 of your report, you allege (presumably by way of example) that in its analysis of the claims, the Navy found that "labor costs alone were inflated by about $11 million". (Emphasis supplied.) The implication of this statement is that there were other inflated costs in addition to the allegedly inflated labor costs. If this were true, it might be prudent, to say the least, for you to indicate what other costs were inflated, rather than employing a McCarthy-type innuendo.

In fact, the labor costs were not "inflated". The man hour figures which you recite are accurate. However, what you either did not know or failed to state was that the excess man hours resulted from a method of estimating additional work which was employed by Avondale because its books and records did not reflect a record keeping by claim and an estimating basis had to be used. The use of this particular estimating process was at all times well known to, and accepted by, the Navy. The system had inherent in it the danger that with the enormous number of claim items to be estimated, an overstatement or understatement against

APPENDIX III



total actu[illegible]ld result. Both Avondale and the Navy were aware of this d[illegible]d when the estimating process was completed, Avondal[illegible]he totals derived with the total booked actual. This com[illegible]ison rea[illegible]ly revealed the overstatement of hours, which was immediate[illegible]disclose[illegible]to the Navy. 7/

At all times in the fact-finding and negotiations (such as they were) of the claim, the Navy was aware of this estimating ideosyncrasy, and we must presume (logically) that it was taken into account by the Navy in its settlement figures. Our assumption in this regard is clearly supported by the Navy's own documents, which disclose that the Navy was well aware of both the nature and extent of this man hour overstatement and did, indeed, take it into account. 8/

We fail to perceive what possible good or productive results can be obtained by making warped and condemnatory charges such as the foregoing. Both the statements and the implications, as you should see, create a dramatic misimpression of our company's dealings with the Navy. While such charges may have a politically dramatic effect, they do not lend themselves to the resolution of shipbuilding procurement problems, nor do they promote any particular search for truth.

Your final allegation suggests that the documentation which we provided was inadequate, although traceable to our records. More specifically, you state that the Navy "claims team" "reported" that much of the data which it needed for its analysis was not provided by the contractor. The limited portions of the draft report which you furnished to us failed to disclose whether or not you sought, or were given, any specific evidence supporting this rather general allegation. Since the allegation is false and grossly unfounded, we suspect it more represents a casual remark by Navy personnel than a careful review by you. A review of our records discloses that the Navy received all of the data which it requested. Moreover, the Navy received a great deal of additional

7/ The overstatement was revealed and discussed at length by the company in a letter to the Navy dated December 5, 1974. A copy of this letter is appended hereto as Exhibit A.

8/ This fact is evidenced by the Navy's "Point Paper", titled, "Overstated Incurred Manhours", which discusses this man hour computation problem and was forwarded to us by a Navy letter dated 3 April 1975.

data which it needed but failed to request. As our discussion above indicates, what the Navy "needed" depended on which of the three claims review efforts over 5½ years was involved, who the Navy's dramatis personae may have been at a given point in time, and what particular format of the claims the Navy was then promoting. It is not unfair to state that over the period of time consumed by the last Navy negotiation effort (December, 1972 through June, 1975), the Navy by and large had little or no comprehension either of what was needed or of what was useful in connection with claim presentation and settlement. The personnel involved, as previously stated, changed constantly; the requests for documentation frequently conflicted; and a great deal of documentation requested appears never to have been reviewed.

Finally, you note that the Navy spent 80 man years and $1.8 million in analyzing and settling our claim. You also recite that some unnamed member of the Navy "claims settlement team" attributed the time and cost to our failure to provide "documentation suitable for evaluating a cause and effect relationship".

This amorphous statement is well known in the shipbuilding industry. It has been used over the last ten years by the Navy to explain virtually every failing which the Navy has experienced in dealing with the shipbuilding industry. Notwithstanding our familiarity with this statement over many years, we have yet to comprehend its meaning. Our difficulty in this connection is well characterized by the fact that in connection with the subject claims the Navy had, over a 5½ year period, three radical changes of mind as to what constituted "suitable documentation". It is extremely unfortunate that you would choose to adopt such statements apparently without any effort to ascertain their meaning or to ascertain whether or not they have any meaning at all. We assure you that the documentation which we provided to the Navy over 5½ years was in each case suitable for what the Navy apparently then had in mind. In each case the Navy gave us reasonable assurance that the documentation was suitable, and in each case the Navy apparently itself concluded that the documentation was suitable, because the Navy attempted to settle the claims on all three occasions.

APPENDIX III



## CONCLUSION

Your foregoing allegations serve little purpose when they are poorly founded in fact. They do tend to mask entirely the inequity of the Navy's processing of the laims, and to cast the Navy personnel in a favorable, complimentary and besieged light. While this may well serve the Navy's purposes, such unfounded accusations are hardly beneficial to Congress in carrying out its legislative duties. The accusations tend to perpetuate the antagonism which already exists in a high degree between the shipyards and the Navy; the accusations tend to suggest remedial and perhaps oppressive legislation where very different legislation is warranted; and the accusations discourage the shipyards from further dealings with a customer who apparently is quite willing to misrepresent its past dealings.

A more nearly accurate view of the Navy's conduct of claims negotiations with a shipbuilder is to be gleaned from the recent decision of the United States District Court in U.S. v. Newport News Shipbuilding and Dry Dock Company. There, Judge MacKenzie quite accurately noted the Navy's bad faith in the conduct of claims negotiations. He noted, moreover, the policy machinations which have typified the Navy's approach to claims, the confusion in administration, the everchanging tactics for the handling of such claims, and the duplicity of the Navy in its dealings with a contractor. What the Court described, we assure you, is not exceptional in the context of shipbuilding claims negotiations with the Navy, but accurately portrays what this company experienced over the $5\frac{1}{2}$ year period during which the DE 1052 Class claims were under review.

The meager material which you have provided to us hardly affords a reasonable opportunity to meet the vague and very general allegations which you have made. We hope you realize that such allegations disparage our business and can have an extremely negative result in future relationships between this company and the Navy.

It is manifestly unfair for you to presume to present so cursory, lopsided and incomplete a report to Congress. This is particularly true in an environment in which the shipbuilding industry is continuously

criticized and its customer, the Navy, apparently blessed. An examination of the shipbuilding claims problems is clearly warranted, but we do not believe the subject has been fairly treated in this draft report. Should you wish to do so, we would meet with you to correct the substantial misimpressions which you apparently now have.

Yours very truly,

Edwin Hartzman

Edwin Hartzman
President

ab

APPENDIX III

AVONDALE SHIPYARDS, INC.

P. O. BOX 50280, NEW ORLEANS, LA. 70150 • PHONE: 776-2121 • AREA CODE 504
WESTERN UNION TELEX:
ENGINEERING AVONENG 58-245
PURCHASING AVONPUR 58-246

5 December 1974
In Reply Refer To:
Ser. DE1052-6915
Ser..DE1078-9511

Supervisor of Shipbuilding
Conversion and Repair, USN
Eighth Naval District
Building 16
Naval Support Activity
New Orleans, Louisiana 70140

Attention: Captain R. A. Jones, Contracting Officer

Subject: ASI Job No. C4-1200 - Contract NObs 4784
Ocean Escorts DE 1052 Class
ASI Job No. C6-1400 - Contract N00024-67-C-0220
Ocean Escorts DE 1078 Class
RECAPITULATION OF CLAIMED MANHOURS

Dear Captain Jones:

As you know, we have now completed the submission of all portions of our claim under the two DE 1052 contracts. We have also made a determination from our bid and from our books and records of the recorded "overrun" of manhours representing the difference between our total actual manhours and our originally anticipated manhours. The latter figures equate to a "total cost" conclusion.

Our purpose in this exercise is to determine whether our claimed manhours are the same as our total "overrun" of manhours. As you are aware, we did not, in the preparation of the claim, employ a total cost approach. To the contrary, we sought to meet Navy criticism of other claims by employing our books and records relating to changed and delayed work, including our work order system, to present a wholly analytical substantiation of the claims. Where work orders directly evidencing the additional manhours were not available or were not completely representative of the additional manhours (as was true in many cases), we reconstructed from other documents, information and expert judgment the total additional manhours applied to the claimed effort. Such reconstruction was particularly necessary where disruption was being evaluated.

It is obvious that while the process which we followed is far preferable to the total cost approach, which tends to "back into" the evaluation of each claim item, there was no way we could determine in advance that the labor hours which were being claimed were exactly the same number as would be disclosed by a "total cost" type computation. Moreover, there was little likelihood that the two totals would be the same.

Our analysis now indicates that the total hours claimed is greater than the number derived from our "total cost" analysis for some labor crafts and less for other crafts; this discrepancy is not surprising. In total, we have claimed more hours than were shown by the "total cost" type computation. At this time, however, we are unable to determine whether this difference represents an "overclaim" or an overestimate of the total manhours in the various crafts which would have been incurred absent the claimed changes and delays.

We are bringing these facts to your attention since an attempt to "reconcile" the two results is natural in this case and since we believe the difference should itself be the subject of negotiation. We shall be pleased to discuss this matter with you at your convenience.

Yours very truly,

AVONDALE SHIPYARDS, INC.

R. L. Woodfin
Vice President - Manager
ASI Claims Group

RLW/HLF/ho

**Newport News Shipbuilding**
A Tenneco Company

4101 Washington Avenue
Newport News, Virginia 23607
(804) 380-2000

February 28, 1977

Mr. R. W. Gutmann, Director
U. S. General Accounting Office
441 G Street, N.W.
Washington, D. C. 20548

Dear Mr. Gutmann:

Your letter dated February 15, 1977, addressed to Mr. Wilton E. Scott, President of Tenneco Inc., contained for comment some sections of your draft report entitled "Shipbuilders' Claims--Problems and Solutions." This letter has been referred to me for reply as I am the Chairman and Chief Executive Officer of the Company involved.

With regard to the request for comments, we are not aware of any review made at Newport News Shipbuilding and Dry Dock Company. We are aware that the General Accounting Office made a review in the office of the Supervisor of Shipbuilding and the local office of the Defense Contract Audit Agency.

Furthermore, your letter provides us only a portion of your draft report; therefore, we are unaware of its total contents as to underlying factual data, conclusions and recommendations. As the portions you have furnished contain errors, we consider it imprudent to comment on only those portions without an opportunity to consider them within the total context of the report.

In the absence of this supporting data, we see no point now in commenting on conclusions which have already been reached.

Yours very truly,

J. P. Diesel
Chairman and Chief Executive Officer

One duplicate to Mr. Wilton E. Scott
Tenneco Inc.

APPENDIX V

# Bethlehem Steel Corporation

BETHLEHEM, PA. 18016

W. C. BRIGHAM
VICE PRESIDENT, SHIPBUILDING
D. H. KLINGES
ASST. VICE PRESIDENT, SHIPBUILDING

1 March 1977

U. S. General Accounting Office
Procurement & Systems Acquisition Div.
Washington, D. C. 20548

Attention: Mr. John F. Flynn
Deputy Director

Gentlemen:

This is in response to your letter dated 15 February 1977, addressed to Mr. F. W. West, Jr., which forwards for our review and comment sections of your draft report entitled, "Shipbuilders' Claims--Problems and Solutions." Your letter requests our comments within 15 days.

After reviewing your draft report, we conclude, as we will make clear, that we cannot respond with meaningful comments.

The somewhat incomplete sections of your draft report made available to us state in summary form your description of the problem and your conclusions on the subject of "Contractors' Claims Have Been Inflated and Not Adequately Documented." The Bethlehem Steel Corporation claim associated with Contract NObs-4998 for construction of two ammunition ships for the U. S. Navy is used in the report as illustrative of the problem and your conclusions.

Our review of your draft report causes us to seriously question its objectivity. The report asserts Navy conclusions on claim documentation and claim inflation. We must assume, therefore, that you accept the Navy conclusions without your own review of our documentation.

With regard to the Bethlehem Steel claim discussed in your draft report, our documentation and conclusions and those of the Navy consistently differed. We provided the Navy voluminous documentation of our position both before and during negotiations. The Navy provided us with only preliminary documentation. We agreed to a negotiated settlement at a loss in preference to our other alternative of protracted ASBCA and/or court proceedings. We did not then or now agree with the Navy conclusions on our claim. We therefore do not propose any further response.

Very truly yours,

W. C. Brigham

APPENDIX VI

GENERAL DYNAMICS CORPORATION
Pierre Laclede Center
St. Louis, Missouri 63105

Max Golden
Vice President, Contracts

314-862-2440

25 February 1977

United States General Accounting Office
Procurement and Systems Acquisition Division
Washington, D. C. 20548

Attention: Mr. R. W. Gutmann

Gentlemen:

Your letter of February 15, 1977 requested our review and comment on sections of the draft report entitled "Shipbuilders' Claims - Problems and Solutions." While your letter indicates that the report discusses a contract performed at our Electric Boat Division, we assume, based on the content of the report, that you meant instead our Quincy Shipbuilding Division. We are pleased to provide you with the following comments based on our experience in negotiating settlement of the claims at that division.

First, the report correctly states the claim amount, contract price and costs incurred. We also believe the report fairly describes the problem faced by the contractor and the Navy in quantifying the impact of disruption and delay. We are concerned, however, with any suggestion in the draft report that our AS claim was submitted without adequate supporting data and that the lack of such data contributed significantly to the extreme period required for negotiation and settlement. We cannot believe that this general conclusion is accurately addressed to the claim at Quincy. In fact, we were advised by the Navy that our claims were the best documented and supported claims ever received on a major shipbuilding program. Notwithstanding this achievement, more than three years were required to negotiate settlement of the AS claims, an unreasonable period by any standard.

The draft report makes a point of the fact that in each of the four claims examined it was necessary for the Navy to request additional data from the contractors. In our view this is inevitable in matters of this complexity where reason and judgment must be applied. What is adequate for one analyst is often insufficient for another. Further, additional data was frequently sought by the Navy as an independent test of the validity of the analysis and supporting information furnished by the contractor. The inordinate delay which occurred in

settling the claims at Quincy was not caused by a failure to provide supporting data at the outset of the evaluation. Rather it was prolonged indecision on the part of the Navy in determining what and how much data it required to reach a position on the issues. In our view the Navy floundered at the beginning in its attempts at performing the analysis and then carried to an extreme its request for further justification of estimates. This delay was further aggravated by personnel changes by the Navy which led to different analytical approaches and requests for rejustification of previous analyses.

Also, we cannot agree with the report's characterization of the difficulties in providing documentation as one of laxity on the part of this shipbuilder. To the extent we relied on the memories of our shipyard personnel for corroboration of the disruption impact, we did so because it proved to be the best evidence. In fact, the inordinate period taken by the Navy to evaluate the claims undermines the shipbuilder's ability to support the evaluation where personal memory is the principal source.

The draft report finds that some claim amounts were inflated. The basis of this finding is not disclosed, at least in the portion of the report furnished, and there is no indication that this conclusion applied to the AS claim. It is to be hoped that the difference between the value of the claim submitted and the amount accepted as settlement has not been interpreted as proof that claims were inflated. In the interest of fairness, we think that the report should recognize that substantial differences in contractor and Navy position are inevitable in areas where judgmental estimates must be used. Further, it should be apparent that some contractors have been driven to acceptance of settlements at lower amounts than considered fair and equitable when faced with the alternative of prolonging what was already an excessively long negotiation or filing an appeal which would delay settlement several years at least. Either alternative further erodes the value of the settlement, which already is substantially reduced because of inflation and the loss of use of settlement funds during the evaluation period.

Despite having submitted what the Navy termed a model claim, and having made available all records and data requested, almost four years elapsed from submittal to settlement of the last claim at Quincy Shipbuilding Division. During this period the Navy approved provisional payments of only 35% of the amount finally agreed to by the Navy as its obligation. Even by the Navy's numbers General Dynamics was obliged to finance over $60 million of work which had already been completed and delivered while the evaluation and negotiations proceeded.

APPENDIX VI



It is very disappointing to find that in the sections of your draft report provided to us, the only recommendations for improvement of this very unfair situation concern supporting data from the contractors. We can only hope that the remainder of the report has examined the other factors which bear on this problem, and that your recommendations include an improvement in the capacities and experience of the Navy claims teams to be commensurate with the complexities of the claims. Also, we urge that your report make clear the inequity borne by this company and other shipbuilders while waiting upon the Navy's evaluation process, and include recommendations for changes in policies regarding interest as part of the final settlement and prompt and more realistic provisional payments.

Sincerely,

Max Golden

Max Golden

nls

APPENDIX VII

DEPARTMENT OF THE NAVY
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20350

31 MAR 1977

Mr. R. W. Gutmann
Director, Procurement and Systems
Acquisition Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Gutmann:

This is in reply to your letter to the Secretary of Defense regarding your report dated 15 February 1977, on "Shipbuilders' Claims - Problems and Solutions", OSD Case #4549, Code 950294.

In general, the report is considered to portray fairly the Navy's actions and procedures to assure reasonable settlements. In order to clarify some statements in the report, the attached suggestions are forwarded for consideration in the preparation of your final report.

I appreciate this opportunity to comment on your draft report.

Sincerely,

John J. Bennett
Assistant Secretary of the Navy
(Installations & Logistics)