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Fact Sheet for the Chairman, Committee on Armed Services, House of Representatives

July 1991

ARMY CONTRACT ADJUSTMENT BOARD

Decision to Grant Contract Relief to Action Manufacturing Company

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GAO

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National Security and
International Affairs Division

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The Honorable Les Aspin
Chairman, Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

As requested, we are answering certain questions regarding the extraordinary contractual relief the Army Contract Adjustment Board granted to Action Manufacturing Company under Public Law 85-804. Specifically, we have addressed the following questions:

- Why did the Army provide greater debt relief than Action requested?
- Did the $24.5 million relief include converted cost-plus-no-fee contracts as well as payment of Action's debt?
- What was the basis for the determination of Action's essentiality to the national defense?
- How was the relief financed?
- How many awards has the Army Contract Adjustment Board granted during the past 5 years, and what were the amounts of the awards?

We have discussed the answers to these questions with your staff.

Background

Action Manufacturing Company produces munitions and fire control devices for the U.S. Army. The company was founded in 1946 as a small machine shop. Over the years, Action built a reputation as a responsive, responsible, quality producer. Virtually all of the company's sales are to the government. The company is located in the Philadelphia area with an explosives manufacturing facility in Atglen, Pennsylvania.

In 1985, the sole owner and founder of Action sold the company to company employees through a leveraged buy out. Soon after the sale of Action, the defense build-up began to slow, shrinking the market for Action's products. Additionally, with the passage of the Competition in Contracting Act of 1984, Action faced more and stiffer price competition than in the past, further diminishing its sales of military products. According to Action, the combination of these factors forced management to submit bids at or below cost in order to continue receiving new work.

In February 1986, a Defense Logistics Agency (DLA) financial surveillance report revealed that Action had a negative working capital (short-term liabilities in excess of short-term assets) of $8.5 million. This report apparently was not provided to Army officials until March 1990. During 1986, 1987, and 1988 DLA conducted additional surveys but did not indicate that Action had financial problems. In March 1989, the Defense Contract Management Administration Organization in Philadelphia received a Defense Contract Audit Agency audit report again indicating that Action had financial problems.

Under the strain of low bids and a bank loan for financing the leveraged buy out, Action ran out of cash in April 1989, laid off most of its employees, and ceased operations. All work on government contracts stopped.

On June 12, 1989, following a series of meetings between Action, its bank, and Army officials, Action began to rehire employees and resumed operations to produce the items needed by the Army. Its bank continued to provide working capital for Action on the condition that Action would file a request for extraordinary contractual relief under Public Law 85-804.

Authority for Granting Relief

Public Law 85-804, enacted on August 28, 1958, empowers the President to authorize departments and agencies to enter into contracts or amend existing ones to grant extraordinary contractual relief whenever he deems that such action would facilitate the national defense. Executive Order Number 10789, dated November 14, 1958, extended this authority to the Secretaries of Defense, the Army, the Navy, and the Air Force.

Part 50 of the Federal Acquisition Regulation (FAR) establishes a uniform procedure for processing requests for relief submitted pursuant to Public Law 85-804. FAR 50.302-1(a) provides that when an actual or threatened loss will impair the productive ability of a contractor whose continued performance on any defense contract or as a source of supply is found to be essential to the national defense, the contract may be amended without consideration, but only to the extent necessary to avoid such impairment of the contractor's productive ability. Contractual amendments for amounts over $25 million require congressional notification.

Results in Brief

Our review disclosed the following:

- The relief provided exceeded that requested primarily because of the inclusion of bank debt and working capital.
- The cost-plus-no-fee contracts and bank debt are included in the $24.5 million relief ceiling.
- According to the Army, Action was essential to the national defense because of its impact on the Army's mobilization capability, production at the Army's ammunition plants and arsenals and other government contractors, and readiness.
- The Army financed the relief from its Conventional Ammunition Working Capital Fund.
- The Army Contract Adjustment Board has granted four awards since 1986 totaling about $36 million, including the $24.5 million awarded to Action.

Appendix I provides detailed information on the results of our review.

We conducted our work at the U.S. Army Armament, Munitions, and Chemical Command, Rock Island, Illinois; the Army Contract Adjustment Board in the Pentagon; the Defense Contract Management Administration Organization in Philadelphia, Pennsylvania; and Action Manufacturing production facilities in the Philadelphia area. We also contacted the Army Materiel Command, Alexandria, Virginia. Our review was conducted from October 1990 to April 1991 in accordance with generally accepted government auditing standards.

As arranged with your office, we did not obtain formal agency comments, but we discussed our findings with Army officials. They agreed with our findings.

We will send copies of this fact sheet to the Secretaries of Defense and the Army, the Chairman of the Army Contract Adjustment Board, the Director of the Defense Contract Management Administration Organization, the Director of the Defense Logistics Agency, and the Director of the Defense Contract Audit Agency. Copies will be made available to others upon request.

GAO staff members who made major contributions to this fact sheet were Henry L. Hinton, Associate Director and Fred Dziadek, Assistant Director, Army Issues, Washington, D.C.; Antanas N. Sabaliauskas, Evaluator-in-Charge and Susan B. Cuesta, Evaluator, Chicago Regional Office.

If you have any questions, please contact me on (202) 275-4141.

Sincerely yours,

Richard Davis

Richard Davis
Director, Army Issues

Questions and Answers Regarding the Extraordinary Contractual Relief Provided to Action Manufacturing Company Under Public Law 85-804

Why Did the Army Contract Adjustment Board Authorize Greater Debt Relief Than Action Requested?

In its September 1989 request for extraordinary contractual relief under Public Law 85-804, Action requested relief to cover increases in costs on its current contracts, certain vendor debts, and forgiveness of debts owed to the government. The relief requested was $9.3 million.

In December 1989, Action revised and increased its request to approximately $19.2 million to include forgiveness of unliquidated progress payments of $10.0 million—payments made to Action for items that had not been delivered.

The U.S. Army Armament, Munitions, and Chemical Command (AMCCOM) reviewed Action's September 19, 1989, proposal and recommended relief of approximately $18.1 million that included forgiveness of unliquidated progress payments of $9.6 million. In June 1990 the Army Contract Adjustment Board (ACAB) granted Action relief not to exceed $24.5 million. Although the relief provided by the Army under ACAB's decision excluded unliquidated progress payments, it exceeded the amounts requested by Action (in December 1989) and recommended by AMCCOM primarily because of the inclusion of bank debt and working capital.

The amounts of relief and its components that Action requested, AMCCOM recommended, and the Army provided under ACAB's decision are summarized in table I.1.

Table I.1: Relief Amounts Requested, Recommended, and Provided

Relief items	Petition 9/19/89	Petition 12/23/89	AMCCOM's recommendation 12/26/89	Implementation of ACAB's decision
Cash payments				
Bank debt	0	0	0	$11,500,000
Vendor/trade debt	$3,564,441	$3,567,317	$3,827,674	3,800,000
Other liabilities[a]	926,310	1,650,870	797,980	1,500,000
Estimated increased costs to complete contracts	3,683,000	3,683,000	3,274,955	3,564,393
Working capital	0	0	0	2,500,000
Relocation/consolidation of fire control facility	300,000	300,000	248,450	0
Subtotal	**$8,473,751**	**$9,201,187**	**$8,149,059**	**$22,864,393**
Non-cash items				
Termination of contract for mine detectors	813,316	0[b]	424,666	1,635,607
Unliquidated progress payments	0	10,000,000	9,554,777	0
Subtotal	**$813,316**	**$10,000,000**	**$9,979,443**	**$1,635,607**
Total Relief	**$9,287,067**	**$19,201,187**	**$18,128,502**	**$24,500,000**

[a]"Other liabilities" includes federal unemployment compensation, workman's compensation, and state unemployment compensation.

[b]No dollar value was provided.

As shown in table I.1 the Army provided $11.5 million in relief for bank debt (which Action incurred in the leveraged buy out) and $2.5 million in working capital. According to ACAB, it decided that since the bank debt owed by Action was large, the possibility of foreclosure threatened the company's viability. Therefore, the Army negotiated with the bank to reduce Action's total bank debt of approximately $30 million to $11.5 million, and enabled the company to repay the remaining bank debt. The Army provided working capital to enable Action to continue to produce the items needed by the Army.

Action did not include the unliquidated progress payments in its September 1989 petition. However, the company included unliquidated progress payments of approximately $10 million in its December 1989 petition. Action requested that these unliquidated progress payments be forgiven in order to pay off the short-term debt owed to the bank. The Army did not include the unliquidated progress payments in the relief package.

Did the $24.5 Million Relief Include the Converted Cost-Plus-No-Fee Contracts as Well as Payment of Action's Debt?

The Army converted Action's firm-fixed-price contracts into cost-plus-no-fee type contracts to eliminate the repeated contractual modifications that would have been required if contract costs increased. The cost-plus-no-fee contracts are included in the $24.5 million relief ceiling. As previously discussed, the relief provided includes bank debt but not unliquidated progress payments.

What Was the Basis for the Determination of Action's Essentiality to the National Defense?

In providing relief to Action, ACAB concluded that both Action's continued performance on existing contracts and the continued operation of Action were essential to national defense. When ACAB awarded the relief in June 1990, Action had 17 government contracts—15 Army contracts, 1 Navy contract, and 1 Air Force contract. The total dollar value of these contracts was $63.2 million, of which $58.6 million were Army contracts. Action's production also impacted other government contracts and munitions programs valued at $325 million.

According to the Army, Action was essential to the national defense on the basis of the company's impact on:

- the Army's mobilization capability,
- production at Army ammunition plants and arsenals and other government contractors, and
- readiness.

Impact on Mobilization Capability

The Army determined that the loss of Action as a source of supply would result in a decrease in the Army's mobilization capability until new producers could be found. The items Action produces that have an impact on the Army's mobilization include:

- Ammunition Items
  M904E4 fuze
  M1 delay plunger
  M509A2 fuze
  M227 fuze
  Burster f/M825
  M567 fuze
  M739A1 fuze

M935 fuze
M936 fuze

- Fire Control Devices
  M145 telescope mount
  M10A6 ballistic drive
  M21A1 telescope mount
- Safe and Arm Assemblies
  BLU-91/B safe and arm assembly
  BLU-92/B safe and arm assembly
  M74 safe and arm assembly
  M75 safe and arm assembly
  M70 safe and arm assembly
  M73 safe and arm assembly

Impact on Production at Army Ammunition Plants and Arsenals and Other Government Contractors

According to the Army, the loss of Action as a current producer would shut down, or interrupt production at, five Army ammunition plants (AAP) and arsenals and two contractors that use Action's products as components for production.

- Louisiana AAP: The Hydra 70 production line would be shut down.
- Iowa AAP: The Remote Anti-Armor Mine (RAAM) load, assemble, and pack line was already shut down because of the interruption of Action's supply of RAAM M70/73 safe and arm assemblies. Fifty-four employees were laid off at an estimated cost of about $1 million. In addition, the load, assemble, and pack line for the Gator/Volcano mines would have had to be shut down on June 30, 1990, without BLU-91/B safe and arm assemblies from Action. This shutdown would have resulted in the additional layoffs of 14 employees.
- Lone Star AAP: The load, assemble, and pack line for the Gator BLU-91/B mine would be shut down. This shutdown would result in the layoff of 79 employees.
- Milan AAP: Ten employees would be laid of because of the interruption of Action's supplies of M739A1 and M751 fuzes.
- Pine Bluff Arsenal: Interruptions of Action's supply of delay detonators, bursters, and safe and arm assemblies for the 155-mm M825 canister would result in the reassignment of 55 employees.
- Accudyne Corporation: The BLU-92/B body assembly line at Accudyne Corporation would be shut down. The Army supplies Action's Gator BLU-92/B safe and arm assemblies to Accudyne as government-furnished material.

- Aerojet Ordnance Corporation: The Gator mine production line would be shut down because of the nonavailability of Gator BLU-91/B and BLU/92/B mines.

The Army estimated that the total costs associated with these shutdowns or disruptions in production could be several million dollars. The Army also projected that nine weapons systems would not be delivered within the funded delivery period without production and delivery of the products supplied under Action contracts.[1]

According to Army estimates, the value of these nine weapons systems was approximately $346.7 million, as shown in table I.2.

Table I.2: Value of Weapons Systems for Which Action Supplies Critical Components

Dollars in millions

System	Program value
Hydra 70 rocket	$9.1
Remote Anti-Armor Mine (RAAM)	149.2
Gator mine	40.0
Volcano mine	23.7
Modular Pack Mine System (MOPMS)	62.1
Ground Emplaced Mine Scattering System (GEMSS)	16.2
M739A1 fuze	7.8
155-mm M825 canister	28.0
M751 fuze	10.6
Total	**$346.7**

Impact on Readiness

According to the Army, cessation of operations at Action would delay the availability of munitions systems such as the Marine Corps urgently needed RAAM projectiles and impact load, assemble, and pack operations, near-term force requirements, and war reserve requirements. According to the Army, any production schedule delays at Action would adversely affect Marine Corps' readiness.

How Was the Relief Financed?

The Army financed the relief from its Conventional Ammunition Working Capital Fund (CAWCF). CAWCF was created to account for ammunition procurements for the Army, Navy, Marine Corps, Air Force, and

[1]The "funded delivery period" for an ammunition item is defined as the time in months from the first delivery of the ammunition item to the last delivery for a specific fiscal year's procurement. It begins the first day of the last month of the procurement lead time and ends 12 months later.

foreign military sales. The armed forces' appropriated funds and foreign military sales receipts are deposited into the CAWCF account to pay for the procurement of ammunition items. The fund is used to consolidate ammunition orders from the armed forces and foreign military sales, buy or manufacture the items, and fill the services' and foreign military sales orders. According to the Army, its authority to use CAWCF to finance the relief was based on Program Budget Decision No. 450, issued in 1985. The decision stated that CAWCF realized a $58.3 million surplus as a result of foreign military sales.

Table I.3 shows that as of February 1, 1991, the Army had disbursed $17.8 million of the relief amount.

Table I.3: Relief Disbursed to Action as of February 1, 1991

Payment of bank debt	$11,500,000
Payment of vendor/trade debt	3,800.000
Payment of other debt	1,500,000
Working capital	1,000,000
Total	**$17,800,000**

The Army also terminated Action's $1.6 million contract with the U.S. Army Troop Support Command for undelivered mine detectors, at no cost to Action.

The remaining amount is available to finance the increased costs of Action's contracts and to provide additional working capital. In its petition in December 1989, Action requested contract price increases of $3,683,000. The Army, pursuant to the ACAB's decision, agreed to provide $3,564,393 for increases in Action's contract costs. However, in February 1991 the Army estimated that increases in the overall costs of completing the contracts may be lower than provided for in the relief granted. The Army's procurement contracting officer has authority to allocate the remaining amount to contracts, or to fund the company's working capital needs.

How Many Awards Has ACAB Granted During the Past 5 Years, and What Were the Amounts of the Awards?

The number and amount of awards the Army Contract Adjustment Board made during the last 5 years are summarized in table I.4.

Table I.4: Summary of Army Contract Adjustment Board Awards

Calendar year	Number of grants	Amount of relief authorized
1990	1	$24,500,000
1989	0	
1988	2	7,230,791
1987	0	
1986	1	4,188,473
Total	**4**	**$35,918,264**

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