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Financial Capability Of  
Lockheed Aircraft Corporation  
To Produce C-5A Aircraft B-169300

Department of Defense

***BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES***

APRIL 12, 1971

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#### ABBREVIATIONS

DCAA	Defense Contract Audit Agency
DDT&E	design, development, test, and evaluation
GAO	General Accounting Office
LMSC	Lockheed Missiles and Space Company

## CHAPTER 1

### INTRODUCTION

The General Accounting Office has reviewed the financial data submitted to the Office of the Secretary of Defense by the Lockheed Aircraft Corporation in support of its request for financial assistance. The objective of the review was to examine into the financial capability of Lockheed to manufacture and deliver C-5A aircraft.

Senators William Proxmire and Richard S. Schweiker requested the General Accounting Office in September 1970 to conduct a study of Lockheed's financial capability to complete and deliver C-5A aircraft. In addition, Congressman William S. Moorhead raised certain questions regarding the Department of Defense plan to settle the disputes with Lockheed in connection with the C-5A aircraft contract.

Lockheed's financial troubles were disclosed in a letter dated March 2, 1970, from the chairman of the board of the Lockheed Aircraft Corporation to the Deputy Secretary of Defense in which he cited the firm's problems on four major defense programs, Navy shipbuilding, the motor for the Short Range Attack Missile, the AH-56A (Cheyenne) helicopter, and the C-5A aircraft. He asserted that the unprecedented magnitude of the differences to be resolved on these programs would make it financially impossible for the company to complete performance of these programs if Lockheed has to await the outcome of litigation before receiving further financing from the Department of Defense. (See app. I.)

Lockheed indicated that, in its opinion, the cause of its difficulty was related to the fact that three of the above programs were awarded under the total package procurement concept. This method of procurement envisions procuring the design, development, production, and support at the outset of the acquisition phase to introduce and maintain a weapon system in the inventory under a single contract. The concept requires price, performance, and schedule commitments on the part of the contractor. The C-5A aircraft program was the first major weapon system on which the total

package procurement concept was used. Additional details on the C-5A aircraft program are discussed in chapter 2 of this report.

The Deputy Secretary of Defense informed the Congress of the situation and asked that it appropriate an additional \$200 million over the requested appropriation for the C-5A aircraft as an interim measure to permit Lockheed to continue production of the aircraft during fiscal year 1971. On October 7, 1970, the Congress, under Public Law 91-441, authorized to be appropriated \$200 million for use as a contingency fund in the procurement of C-5A aircraft during fiscal year 1971, subject to certain restrictions and controls. This amount was appropriated by the Congress on January 11, 1971, under Public Law 91-668.

Prior to any expenditures from the fund, the law requires the Secretary of Defense to submit to the House and Senate Committees on Armed Services a plan to describe the controls established by the Department to ensure that expenditures from the fund will only be used for reasonable and allocable costs incurred by Lockheed for the production of C-5A aircraft. (See app. II.)

The Department of Defense considers that the letters dated December 30, 1970, from the Deputy Secretary of Defense to the Chairmen, House and Senate Armed Services Committees, which outlined the Department's proposals for resolving the difficulties on Lockheed's defense programs met the requirement of the law for submission of a plan. (See app. III.) We have been advised that as of April 1, 1971, the Department of Defense has not executed any contractual documents relating to the restructured C-5A aircraft contract.

The detailed procedures to be employed by the Department of the Air Force in implementing the law were forwarded to the Chairman of the Senate Armed Services Committee on February 2, 1971. (See app. IV.) We have reviewed these detailed procedures and they appeared to be adequate; however, we plan to examine as to whether these procedures result in the fund being expended only for reasonable and allocable costs incurred by the contractor during our audit of payments made from the fund.

The law also prescribes that the fund cannot be used to reimburse Lockheed for

- costs incurred on any other contract or activity,
- intercompany profits,
- bid and proposals costs, independent research and development costs, and the costs of other unsponsored technical efforts, or
- depreciation and amortization costs on property, plant, and equipment.

The law requires that all payments made from the \$200 million appropriated as an interim measure to permit Lockheed to continue production shall be audited by the Defense Contract Audit Agency. The law also requires the General Accounting Office to audit payments from the fund on a quarterly basis and to submit a report to the Congress within 30 days from the close of each quarter on the results of its audits.

## CHAPTER 2

### C-5A AIRCRAFT PROGRAM

The C-5A aircraft system is to provide a long-range airlift capability at high subsonic speeds. The aircraft is designed to be capable of transporting all equipment and supplies assigned to combat and support units, including items which are too big for any other type of aircraft. The aircraft is being acquired for use by the Military Airlift Command.

Presented below is a brief description of the history, contractual provisions, and current status of the C-5A aircraft program.

#### HISTORY

The requirement for a heavy logistic system, which later became the C-5A aircraft, was first recognized by the Military Airlift Command in October 1961. An Air Force study during the summer of 1963 strongly supported a requirement for a logistic aircraft to replace the C-133 aircraft.

In October 1964, the Air Force prepared a technical development plan for the heavy logistic system which included an estimate of program cost of \$3.423 billion for 120 aircraft, engines, initial spares, preparation of technical and cost proposals for the manufacture of the system, and some miscellaneous items. This plan was submitted to the Department of Defense and approval was received to proceed with the program.

The Air Force requested the Boeing Company, the Douglas Aircraft Corporation, and the Lockheed Aircraft Corporation in December 1964 to prepare detailed technical and cost proposals for the manufacture of the system, by then identified as the C-5A aircraft. Each contract was a fixed-price contract in the amount of \$7.125 million to perform this work. Similar contracts were awarded to General Electric Company and Pratt & Whitney Aircraft Division, United Aircraft Corporation, to prepare proposals for the engines.

Incorporated in these requests for proposals was a requirement that the competitors submit bids under a new concept of contracting called total package procurement. Under this concept, the Air Force envisioned that both development and production of the system, together with as much support as feasible, be procured under a single contract containing a ceiling price as well as performance commitments. This would permit the Government to make a choice between competitors for the development and production of the aircraft. Hopefully, cost savings would be achieved and the Government would benefit by acquiring a reliable product, at the lowest price, through competition for a major portion of its requirements.

These technical and cost proposals were submitted to the Air Force in April 1965. They were evaluated and in October 1965 the Air Force awarded contracts to Lockheed and General Electric for development and production of the airplane and engines.

#### CONTRACT PROVISIONS

The contracts awarded to Lockheed and General Electric were of the incentive type and included options which, if exercised, would cover a 10-year period of production.

Although the Air Force 1964 estimate was based on 120 airplanes, Lockheed's contract covered the design, development, test, and evaluation (DDT&E) of five airplanes; the production of 53 airplanes identified as run A, and certain spare parts and aerospace ground equipment. The contract also contained options for quantities not to exceed 57 airplanes identified as run B and 85 airplanes identified as run C. The estimated or target price of the Lockheed contract for 115 airplanes in DDT&E, run A and run B, was \$1.945 billion.

General Electric had a similar contract for the engines and the target price was \$624 million including \$165 million for the run B option. According to the contracts, the prices for the run C option would be based on projections of run B costs.

The target prices included a 10-percent profit and the contractors were to share with the Government, by adjustment to profit, in any underrun or overrun of the target cost. Each contract included a sharing arrangement whereby, if actual cost was less than target cost, the contractor's profit would increase by 15 percent of the amount of this underrun. If actual cost was higher than target cost, the profit of each contractor would be reduced by 15 percent of the amount of this overrun. The contracts also provided for a ceiling price of 130 percent of target cost.

The contract with Lockheed included a clause whereby the Government had the right to adjust the sharing ratio to increase Lockheed's participation in any underrun to 50 percent and 30 percent, respectively, with the stipulation that target cost, target price, and ceiling price would be increased by about 3.2 percent. The sharing arrangement and the targets were changed soon after contract award in accordance with this clause.

Each contract also contains a clause permitting a revision to the target cost and ceiling price each year beginning with calendar year 1968, to recognize abnormal fluctuations in the price levels of labor, materials, equipment, and subcontracts. Each contract contains a repricing clause which permits the ceiling price to be adjusted upward if actual costs of producing run A exceed the target cost of run A by 30 percent. A formula is included in the contracts to compute the amount of this adjustment.

The contract with Lockheed required that the option for run B be exercised 24 months prior to the scheduled delivery of the first run B unit. The Air Force issued Supplemental Agreement 235, effective January 14, 1969, for production run B which gives the Air Force the right to buy up to the 57 aircraft included in the option quantity. On November 26, 1969, the Air Force issued Change Notice 521 which stated that the Government had allotted funds for the fiscal year 1970 increment of 23 C-5A aircraft.

By letter dated December 3, 1969, Lockheed advised the contracting officer that the issuance of Change Notice 521 unilaterally changed the contract terms. Lockheed contended that the Air Force had previously exercised its option for

57 C-5A aircraft and that Change Notice 521, in effect, was a partial termination for convenience entitling Lockheed to receive appropriate reimbursement of its costs. In response, on December 22, 1969, the contracting officer denied Lockheed's claim and advised the contractor that the decision was a final decision under the "Disputes" procedure. On December 31, 1969, Lockheed advised the Secretary of the Air Force that it was appealing the contracting officer's decision to the Armed Services Board of Contract Appeals. Lockheed's complaint to the Board was filed on March 23, 1970.

## CURRENT STATUS

For fiscal year 1971, the Congress appropriated \$622.3 million for the C-5A aircraft program, including \$544.4 million for production, as shown below.

<u>Funds</u>	<u>Amount</u>
	(millions)
Research and development	\$ 11.6
Procurement, aircraft:	
Aircraft (production)	\$344.4
Interim funding for Lockheed	<u>200.0</u> 544.4
Initial spares	64.8
Military construction	<u>1.3</u>
Total (difference due to rounding)	\$622.3

Concerning the funding of the C-5A aircraft program for fiscal year 1971, the Deputy Secretary of Defense testified on May 27, 1970, before the Committee on Armed Services, United States Senate, that "Of the \$544.4 million required for the C-5A in fiscal year 1971, \$344.4 million is required for prior year unfunded production obligations. Of this amount, \$296 million is for Lockheed." A schedule showing amounts appropriated, obligated and expended by fiscal year for the C-5A aircraft program is shown in appendix V. We have been advised that, in addition to funds previously appropriated, the Air Force intends to request from the Congress for fiscal year 1972 and subsequent years an additional \$544.0 million to complete the acquisition of 81 C-5A aircraft.

The Air Force originally estimated that Lockheed would exhaust the \$296 million shortly after the end of December 1970 and that the \$200 million would be required for work to be done in the remainder of fiscal year 1971. However, Lockheed has not incurred costs at the rate anticipated when the Department of Defense requested the Congress to provide the interim funding for the contractor. Consequently, the Air Force believes that it will not be necessary to start payment from the \$200 million until about mid-May 1971.

The Air Force is considering changing the present C-5A aircraft contract from a fixed-price incentive type to a cost reimbursement type with the Air Force providing the funds to complete the program except for Lockheed absorbing a fixed loss of \$200 million. In addition, Lockheed would not receive payment for certain types of costs listed in Public Law 91-441. The settlement also would preclude any performance incentive fees, or profits on initial spares and on added work related to the scope of the contract which Lockheed otherwise might have earned.

PUBLIC LAW 85-804

Public Law 85-804, enacted in 1958, provides that the President may authorize any department or agency of the Government which exercises functions in connection with the national defense:

"\*\*\* to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made \*\*\* without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense."

This authority is quite broad and the President has authorized the Department of Defense and certain other agencies to exercise that authority. See appendix VI for Public Law 85-804 and appendix VII for Executive Order No. 10789 which implements the law.

We have reviewed the legislative history of Public Law 85-804 and the proposed action is not precluded by the act and is within the intent of the legislative history.

The floor debates in the legislative history of Public Law 85-804, seem to answer in the negative the question whether the act should be limited to small claims. The following colloquy from the legislative history deals with the application of the act:

"Mr. Robsion of Kentucky. Mr. Speaker, there seems to be considerable misunderstanding in the minds of some, including perhaps the gentleman from Missouri, about the necessity of this legislation. Of course, we should always be striving to improve our methods of procurement and the making of Government contracts, especially defense contracts. But there will always be a field where legislation such as this will be needed to take care of unusual situations that will arise in providing for the weapons for national defense. I will give you one example, that of a contract to build a ship. Suppose you

get half through the construction of the ship and something goes wrong, perhaps through bad management, perhaps through something unavoidable, nevertheless, the shipyard finds that it cannot continue under the terms of the contract and complete the ship. The question then arises whether or not the Defense Department should rescind the contract, sue the contractor for damages, and take the ship over to some other yard for completion. But, of course, it cannot work that way. As a practical matter, national defense would require the ship to be completed in that yard, even though it might require the renegotiation of the contract. Writing new laws relating to Government contracts will not take care of a situation such as this. The Defense Department must have the special powers provided by this legislation, where, under the supervision of Congress, they would have leeway to go ahead and get the ship completed, even if, unhappily, in some instances it would require more money.

\* \* \* \* \*

"Mr. McDonough. In other words, the gentleman is informing us that there are many contracts such as contracts for aircraft, to which it applied, missile construction, rockets, as well as shipbuilding.

"Mr. Robsion of Kentucky. Yes.

\* \* \* \* \*

"Mr. Robsion of Kentucky. Yes. Now, there are several reasons why you need this legislation. For example, sometimes the Government must renegotiate a contract without legal consideration, such as in the completion of ships, the case that I mentioned; secondly, there are instances of mutual mistakes that must be corrected in these large and extremely complicated defense contracts; thirdly, of course, you have peculiar situations which must be met from time to time in large defense programs where existing statutory authority is inadequate." (See pp. 14156 and 14157 of the Congressional Record, House, July 29, 1958.)

ESTIMATED ADDITIONAL  
COST TO THE GOVERNMENT

The actions proposed by the Department of Defense to resolve the difficulties being encountered with the C-5A aircraft contract will result in additional costs to the Government. The following schedule which shows additional costs of about \$496.4 million is based on the assumption that all disputes and disagreements existing between the Air Force and Lockheed on the C-5A aircraft contract would be decided in favor of the Air Force.

	<u>Amount</u> (millions)
Estimated cost for Lockheed to complete 81 C-5A aircraft (only allowable costs as defined in section XV of Armed Services Procurement Regulation)	\$3,248.2
Air Force estimate of ceiling price of existing contract	<u>2,528.8</u>
Additional cost in excess of estimated ceiling of existing contract	719.4
Less:	
Proposed settlement loss to be absorbed by Lockheed	\$200.0
Estimated amount of costs disallowed by Public Law 91-441 and under restructured contract	<u>23.0</u> <u>223.0</u>
Estimated additional costs to the Government.	<u>\$ 496.4</u>

ESTIMATED PROGRAM COSTS

The following presentation shows the current estimate of the costs of 81 C-5A aircraft at completion of the program. These estimates, as those of the added costs to the Government above, have not been audited by the General Accounting Office.

Total C-5A Aircraft Program Costs  
as of December 31, 1970  
Based on Air Force and Contractors' Estimates

	<u>Amount</u>
	(millions)
Lockheed Aircraft Corporation:	
Estimated cost for 81 aircraft	\$3,248.2
Initial spares and ground equipment	<u>389.9</u>
	3,638.1
General Electric Company	848.2
Military construction	17.6
Other costs:	
Precontract awards	\$58.0
Ground equipment	54.7
Testing	24.7
Miscellaneous	<u>29.0</u>
	<u>166.4</u>
Total acquisition cost	4,670.3
Less: Proposed settlement loss to be absorbed by Lockheed	<u>200.0</u>
Net acquisition cost	4,470.3 <sup>a</sup>
Additional system (operating) costs programmed through fiscal year 1976 (modifications, replenishment spares, etc.)	<u>339.5</u>
Total cost of program	<u><u>\$4,809.8</u></u>

Reconciliation of Program Costs with  
Estimate of Additional Appropriations Needed to Complete  
Acquisition of 81 C-5A Aircraft

	<u>Amount</u>
	(millions)
Total program costs	\$4,809.8
Less: Funds programmed as of 12-31-70	\$4,026.3
Additional systems costs programmed through fiscal year 1976	<u>339.5</u>
	<u>4,365.8</u>
	444.0
Add: Funds to be provided to Lockheed which it must repay to the Government beginning in 1974	<u>100.0</u>
Funds needed to complete acquisition of 81 aircraft	<u><u>\$ 544.0<sup>a</sup></u></u>

<sup>a</sup> This amount will be reduced to the extent that costs, estimated at \$23 million, are disallowed under Public Law 91-441 and the restructured contract.

## CHAPTER 3

### DEPARTMENT OF DEFENSE EFFORTS

#### TO RESOLVE LOCKHEED'S FINANCIAL PROBLEMS

After the Department of Defense received Lockheed's letter in March 1970 requesting financial assistance, a special group was established within the Office of the Secretary of Defense to compile and analyze data relative to Lockheed's financial problems and to furnish information to the Deputy Secretary of Defense. Also, this group was responsible for determining the reliability of information submitted by Lockheed. We were advised that particular attention was directed by this group to making a comparison of the quantities, types, and schedules of various Government programs shown in Lockheed's data with known and projected Government requirements, since these programs were the bases for a significant portion of the contractor's forecasted sales, costs, and profits.

Lockheed was requested to provide additional data to support, by specific time periods and programs, its short-term cash needs. The following requested information was provided.

1. A 5-year financial forecast.
2. Data relative to extraordinary contractual actions to facilitate the national defense on:
  - a. The C-5A aircraft program.
  - b. The AH-56A helicopter phase II development program.
  - c. The AH-56A helicopter phase III production program.

The financial forecast was based on estimated sales, costs, profits, capital requirements, and similar financial information for the 5-year period 1970 through 1974. The information was developed from Lockheed's budget and forecast system and was based on certain assumptions with regard

to schedule, cost, and delivery of selected military and commercial programs. We were advised that Lockheed's assumptions concerning Government programs (quantity and schedule) in which it is participating were reviewed by Department of Defense officials. Assumptions regarding Lockheed's commercial activity were based on the judgment of Lockheed management.

The data submitted by Lockheed for the C-5A aircraft and the AH-56A helicopter were prepared under the financial relief provisions of Public Law 85-804 as implemented by section 17 of the Armed Services Procurement Regulation. Section 17 requires the contractor's submission to include, in addition to other data, (1) a history and current status of the programs, (2) costs for which it has made payment and those for which it was indebted, (3) estimated costs to complete, and (4) the efforts Lockheed made to obtain funds from commercial sources to enable completion of the programs.

To assist in the analysis, the Defense Contract Audit Agency (DCAA) was requested to review Lockheed's 5-year financial forecast and the contractor's submissions for action under Public Law 85-804. DCAA reviewed the data provided by selected divisions and subsidiaries to Lockheed Aircraft Corporation headquarters which consolidated the information. On a selective basis, forecast rates and factors were checked to Lockheed's accounting records and/or compared with available audit data. In addition, contract amounts and forecasted cash receipts were compared to contract terms and delivery schedules on a sample basis. DCAA also verified the financial data included in the three submissions covering the C-5A aircraft program and the AH-56A helicopter programs for development and production.

The Defense Contract Audit Agency submitted a report on January 13, 1971, to the Office of the Assistant Secretary of Defense (Installations and Logistics) which stated that it had found that (1) historical data used in the computation of the forecast and/or contained in the three program submissions were in agreement with Lockheed's accounting records, (2) forecast data contained in the submissions were derived from data developed under Lockheed's budget and forecast system, and (3) there were no significant discrepancies in Lockheed's forecasting techniques.

DCAA's report also stated that the financial forecast reviewed supported Lockheed's computation of cash requirements which are expected to peak in 1971. Further, it stated that, unless Lockheed could find other means to satisfy its requirements for cash in 1971 over the amount which may be available from banks and airline customers, Lockheed would be unable to complete performance on the C-5A aircraft and the AH-56A helicopter programs without Government financing of costs exceeding the Government's interpretation of existing contract ceilings. DCAA stated, however, that it could not express an overall opinion on the 5-year forecast, since its realization was subject to many complex factors involving considerable uncertainty.

By letters dated December 30, 1970, to the Chairmen, House and Senate Armed Services Committees, the Deputy Secretary of Defense outlined his proposals for resolving the disputes and claims surrounding the various military programs in which Lockheed was participating. A copy of the letter sent to the Chairman, Senate Armed Services Committee is shown in appendix III. A similar letter was sent to the Chairman, House Armed Services Committee.

He stated that the dispute concerning the motor for the Short Range Attack Missile was considered resolved and that the ship claims under five completed contracts had been settled. The remaining ship claims totaling \$159.8 million were still subject to negotiation.

With respect to the AH-56A helicopter research and development program, he proposed that the fixed-price type of contract be converted to a cost-reimbursement type. Under this arrangement, the Army will assume future costs of the program and will reimburse Lockheed for about \$25 million in costs which have been incurred since December 29, 1969.

Under the AH-56A helicopter production program terminated for default in May 1969, the Deputy Secretary proposed to settle the dispute by authorizing the Army to pay \$36 million or the actual amount of the settlement of the claims of unpaid suppliers and subcontractors, whichever is lesser.

The proposal for settlement of the C-5A aircraft dispute consisted of converting the contract to a cost-reimbursement type with the Air Force providing the funds to complete the program except for Lockheed's absorbing a fixed loss of \$200 million. In addition, Lockheed would not receive payment for certain types of costs listed in Public Law 91-441. The settlement also would preclude any performance incentive fees or profits on initial spares and on added work related to the scope of the contract which Lockheed otherwise might have earned.

The Deputy Secretary stated that the actions proposed by the Department of Defense would not guarantee that bankruptcy of Lockheed would be precluded.

Lockheed responded on January 5, 1971, to the settlement proposed on December 30, 1970, by the Deputy Secretary of Defense. (See app. VIII.) Lockheed agreed that the dispute concerning the motor for the Short Range Attack Missile had been resolved and accepted the proposals on the AH-56A helicopter development and production programs. The contractor was not prepared to accept the Navy's offer of \$58 million in settlement of the ship claims and indicated that the continuation of negotiations was preferable. Subsequently, Lockheed has reached a tentative agreement to accept \$62 million in full settlement of the ship claims.

Initially, Lockheed declined to accept the amount of loss on the C-5A aircraft program proposed by the Deputy Secretary of Defense, but the company has changed its position and has agreed to settle for a fixed loss amounting to \$200 million. Lockheed will forfeit \$100 million which it has already provided toward C-5A aircraft costs and will repay the second \$100 million with interest at the prime rate starting January 1, 1974. Repayments will be at the rate of \$10 million or 10 percent of before-tax profits each year, whichever is larger, with an upward adjustment in the event of dividend payments. (See apps. IX and X.)

As security for the \$100 million, the Department will require the contractor to pledge its land, buildings, and personal property located at the Lockheed-Georgia plant. In addition, Lockheed agreed to withdraw from litigation all its claims on the above program.

CHAPTER 4

GENERAL ACCOUNTING OFFICE REVIEW

OF FINANCIAL DATA SUBMITTED

BY LOCKHEED AIRCRAFT CORPORATION

On September 14, 1970, Senator William Proxmire and Senator Richard S. Schweiker requested the General Accounting Office to (1) review Lockheed's financial capability to complete and deliver various quantities of C-5A aircraft and (2) ascertain the total amount which would have to be expended to ensure completion and delivery of such aircraft.

We advised Senator Proxmire and Senator Schweiker on November 19, 1970, that the Air Force estimated that the total program of 81 C-5A aircraft would cost about \$4.6 billion for development, production, initial spares, and directly related construction. The Air Force had not prepared a cost estimate for the 42 C-5A aircraft which are to be delivered by June 30, 1971. On the basis of the rate of expenditures, however, the Air Force believed that about \$4.1 billion would be expended on the total program of 81 aircraft by the time the 42d aircraft is delivered. Included in the \$4.1 billion were costs applicable to aircraft that would be delivered (work-in-progress) subsequent to aircraft number 42.

With respect to Lockheed's financial capability to complete the C-5A aircraft contract, it should be recognized that, pursuant to 10 U.S.C. 2313(b), the General Accounting Office has the authority to examine records which directly pertain to the C-5A aircraft contract and other negotiated Government contracts; however, we do not have the right to require Lockheed to furnish us data on its commercial programs or overall financial condition.

We requested officials of the Department of Defense to make available for our review any information that the Department had relating to Lockheed's financial condition, including information on Lockheed's commercial programs. We were informed that, although the Department did have certain financial information pertaining to Lockheed, it could not be made available to us since the information had been furnished to the Department in confidence and on the basis that it would not be made public. Although under 31 U.S.C. 54 the General Accounting Office has a right of access to any records of any Government department, as a practical matter, there is no sanction available to compel enforcement of our right.

To avoid a time-consuming negotiation regarding our right of access to the information in the hands of the Department of Defense, we inquired of Department officials whether we could review the information at the Department and refrain from copying or reporting it. We agreed that we would furnish to those requesting our review only our opinion as to whether Lockheed had the financial capability to complete and deliver C-5A aircraft. Initially, Department officials declined our suggested approach; however, during subsequent discussions agreement was reached to permit us to review, under the above stipulated conditions, the financial information which Lockheed had furnished the Department.

The Deputy Secretary of Defense advised us on December 9, 1970, that Lockheed was preparing comprehensive financial information in the form required by the Armed Services Procurement Regulation to substantiate actions under Public Law 85-804. It was estimated that the additional data would be submitted in late December and would be audited by DCAA. The Deputy Secretary requested the General Accounting Office to participate in the review of this information.

WORK PERFORMED BY THE  
GENERAL ACCOUNTING OFFICE

Our work was principally performed at the Office of the Secretary of Defense, corporate headquarters of the Lockheed Aircraft Corporation, and three of its major

divisions during the period December 28, 1970, to January 29, 1971. At contractor locations our effort was basically directed toward evaluating the audit procedures and techniques employed by DCAA.

The following statements describe in more detail the work performed by the General Accounting Office at each location.

1. The Office of the Secretary of Defense, Washington, D.C.--At the Office of the Secretary of Defense, we verified the quantity and schedule of Department of Defense programs used as a basis for projecting future sales, costs, and profits to the Department's 5-year defense program. In addition, we determined significant financial ratios from the financial forecast and compared these with similar ratios derived from Lockheed's financial statements from prior years. We also discussed with Department officials the work they had performed to satisfy themselves of the validity of financial data submitted by Lockheed.

2. Lockheed Aircraft Corporation, Burbank, California--At this location we reviewed the study performed by DCAA of the corporate office consolidations and adjustments of budgetary data submitted by operating divisions and subsidiaries. We performed such tests of the study as time permitted and discussed the results with DCAA personnel. We also reviewed records relating to major financing arrangements between Lockheed and the Bank of California National Association. Matters relating to the above areas and to extraordinary actions taken by Lockheed to conserve cash and to find additional sources of revenue were discussed with corporate officials.

3. Lockheed-California Company, Burbank, California--We examined in detail the work accomplished by DCAA in confirming the validity of the financial forecast with respect to the AH-56A helicopter program, the P-3C aircraft and the S-3A aircraft. We examined the data obtained by DCAA and made such independent tests of the data as time permitted. We also discussed these matters with DCAA and Lockheed officials.

4. Lockheed-Georgia Company, Marietta, Georgia--At the Georgia facility, we obtained a schedule of expenditures and receipts showing the amount of cash required to support the C-5A aircraft program and Lockheed's investment in the program. In addition, we compared the August 1970 joint Air Force/Lockheed cost estimate with Lockheed's internal management budgets. We also compared the Air Force and Lockheed interpretations of the contract ceiling price. Further, we examined the scope and quality of DCAA's audit of the joint Air Force/Lockheed cost estimate and the submission by Lockheed as required by the Armed Services Procurement Regulation, section 17, implementing Public Law 85-804.

5. Lockheed Missile and Space Company, Sunnyvale, California--At the Lockheed Missile and Space Company (LMSC), we examined forecast sales of LMSC and the company's methodology for computing cash requirements on the basis of forecast source and application of funds. We also discussed with LMSC officials the forecast profit. Although we cannot express an opinion on the accuracy of the forecast profit, we believe that LMSC used sound procedures in developing its cash requirements.

## CHAPTER 5

### CONCLUSIONS AND RECOMMENDATIONS

We are unable to express an opinion as to the accuracy and reliability of the company-wide financial forecast submitted by Lockheed because of the uncertainty of future transactions and the possibility of encountering unforeseen technological difficulties. Subject to this qualification, the data that we reviewed indicate that Lockheed does not have sufficient financial resources to complete the C-5A aircraft program without Government assistance in financing the costs expected to be incurred in excess of the existing contract ceiling.

Our review of the financial data furnished by Lockheed was completed on January 29, 1971. Subsequently, it was disclosed that Rolls-Royce, Ltd., the manufacturer of the engine for Lockheed's commercial aircraft, the L-1011, had gone into receivership. The full effect of this action on either Lockheed's financial position or Government programs managed by Lockheed cannot be determined at this time.

We agree with the statement made by the Deputy Secretary of Defense in his letters dated December 30, 1970, to the Chairmen, House and Senate Armed Services Committees, that the actions proposed by the Department of Defense will not guarantee that bankruptcy of Lockheed will be precluded. In this respect, since the full effect on Lockheed's financial position of problems presently being experienced by Rolls-Royce cannot be determined, we believe that action should be taken to ensure that the use of funds made available for the C-5A aircraft program will continue to be used on that program even in the event of bankruptcy of the contractor.

Lockheed has indicated that it is taking aggressive management actions to conserve cash and to make the operations of the company more economical. On February 17, 1971, Lockheed officials provided us with a schedule of actions that it had taken to conserve cash. (See app. XI.) We believe that the Department of Defense should take a more active role in confirming the effectiveness of these actions and in identifying additional actions that may be warranted.

In this connection and in support of the above conclusion, we found that, during our comparison of the joint Air Force/Lockheed cost estimate with Lockheed's internal budgets, the cost estimate was about \$172 million higher than the budgets to complete the program. We were informed that this difference of \$172 million was considered by Lockheed to be a management reserve and was a part of Lockheed's management control system since the internal budgets were based on the concept of optimum performance. To the extent that Lockheed meets this optimum performance, the estimated additional cost of \$496.4 million shown on page 12 of this report will be decreased.

### RECOMMENDATIONS

We recommend that the Department of Defense establish close surveillance over Lockheed's activities to ensure that conditions which resulted in previous cost growth and financial difficulties have, to the extent possible, been corrected and are not likely to recur. We recommend also that the Department conduct a review of the "should cost" type of Lockheed's operations concerning the production of C-5A aircraft. The purpose of these recommendations is to give the Government greater assurance that Lockheed's future operations are conducted in an efficient and economical manner and that only necessary costs are incurred in completing the C-5A aircraft.

**APPENDIXES**

LOCKHEED AIRCRAFT CORPORATION  
BURBANK, CALIFORNIA 91503

March 2, 1970

The Honorable David Packard  
Deputy Secretary of Defense  
The Pentagon  
Washington, D. C. 20301

Dear Mr. Secretary:

We have completed a review of the current status of a number of our major Department of Defense programs in connection with which our corporation has filed claims or has been compelled into contractual disputes with the military services. It has become abundantly clear to us that the unprecedented dollar magnitude of the differences to be resolved between Lockheed and the military services make it financially impossible for Lockheed to complete performance of these programs if we must await the outcome of litigation before receiving further financing from the Department of Defense. We consider it imperative that some alternate method of resolution of these differences be immediately and seriously pursued in order to avert impairment of the continued performance of programs essential to the national defense.

We realize that the military services normally expect their contractors to continue performance, including financing, pending administrative review and resolution of any disputable matter. In the present instances, however, the cumulative impact of the disagreements on four programs creates a critical financial problem which cannot be supported out of our current and projected assets and income. We have intensified our cost reduction efforts, have eliminated dividends to our stockholders, have reduced drastically our planned expenditures for fixed assets, and intend to reduce our overhead costs and cut discretionary outlays in all other possible areas. We also intend to continue pursuit of all possibilities of financing from the private sector. Despite these efforts, we must state that we cannot maintain uninterrupted performance on these programs without receiving significant financing assistance from the Department of Defense. Also, in absolute candor, we do not consider that Lockheed, even if it were capable of so doing, should be expected alone to sustain for an indefinite period the financial burden while awaiting the outcome of litigation resulting largely from drastic innovations in procurement procedures utilized by the military services.

LOOK TO LOCKHEED FOR LEADERSHIP

The Honorable David D. Clark

March 2, 1970

However, if absolutely necessary the parties may be forced to have their major disagreements involved in these programs settled through litigation. Indeed our obligations to our stockholders will require us to take this course of action if the only settlement proposals which can be evolved would ruinously deplete our corporate resources. Moreover, it should be recognized that contractual disagreements of such enormous magnitude represent a breakdown in the procurement processes.

Without disregarding our own deficiencies, the common ingredient in three of the four programs which cause our present difficulty, namely, the C-5A, the SRAM, and the A11-56, is the fact that under the Total Package Procurement procedure development was required to be undertaken under a fixed price type contract with concurrent production commitments with respect to price, schedule, and performance. Although it was assumed that state-of-the-art advances were not required in these programs, it is generally admitted that these assumptions were incorrect. Although industry generally, including our company, perhaps erred in competing for contracts under this system, the system itself and its use were the responsibility of the military departments.

We believe that the hindsight of today shows us that the procurement procedure utilized for these programs was imprudent and adverse to our respective interests. We did not contemplate, nor do we believe anyone in the Department of Defense ever contemplated, that these contracts could generate differences of opinion involving such vast monetary amounts as, for example, exist on the C-5A program. Nor did either party appreciate the major hazards involved in undertaking production on the Cheyenne program before technical problems on the development program had been solved. Considering that these problems were known to the Army at the time the letter contract for production was issued in January 1968, and that the parties subsequently had been unable to reach agreement on a definitive contract, the unprecedented action of terminating this letter contract under a fixed price default clause is difficult to understand.

Despite the growing awareness that the total package method utilized in these programs is virtually unworkable, there seems to be little disposition to correct existing contracts on terms which most contractors can accept or to recognize that litigation is a seriously inadequate avenue. Even on the shipyard contracts where the total package concept was not involved, the fact the bulk of the shipbuilding industry has encountered grave trouble as indicated by the more than a billion dollars in contract claims suggests that the system, rather than solely individual deficiencies, was a major contributor to the problem.

Apart from the disastrous potential for our own company and its effect on Department of Defense programs, litigation of these problems may well have grave consequences on the Department of Defense's ability to secure the industrial support which it

The Honorable David Packard

March 2, 1970

traditionally has required, regardless of who ultimately wins. With this in mind, whatever steps may be taken to alleviate our immediate financial problems I wish to urge that the way be left open to negotiate settlements which are within the ability of the corporation to absorb.

Although I know you are generally familiar with the aforementioned programs, I would like briefly to recapitulate the critical financial problems they cause and to urge interim financing actions which should be taken immediately to avoid impairment of continued performance.

#### C-5A

On January 19, 1970, our appeal from the Contracting Officer's decision concerning the C-5A contract dispute was docketed by the ASBCA and our complaint has been filed. All parties are cooperating toward the earliest possible resolution of these issues by the Board, but most optimistically it would appear this cannot be accomplished before late 1971.

In addition, there is a distinct possibility that the decision of the Board may be appealed to the Court of Claims, and consequently a final decision may not be made until 1973 or 1974. The Air Force has indicated it will not provide funds for this contract which will exceed the estimated contract price as the Air Force interprets this contract. Under these conditions, the Air Force funding would at best be adequate only until near the end of this year. However, in order to complete the delivery of 81 aircraft and related items during 1971 and 1972 an additional \$435 million to \$500 million will be required to cover production expenditures. Lockheed cannot provide such funding and believes the Air Force should advance the necessary funds pending the outcome of the litigation. This could be accomplished by an amendment to the current contract which could contain appropriate safeguards for both parties with respect to preserving their rights in litigation.

#### Shipyard Claims

At the present time, the Lockheed Shipbuilding and Construction Company has performed, or is performing, on 9 contracts for several classes of new ships. More than \$175 million of contractual adjustment claims have been presented to the Navy to date. As of December 29, 1969, amounts expended by Lockheed on these claims exceed \$100 million and are expected to continue at a rate of \$3 to \$4 million per month. These claims have been under consideration for many months with provisional payments of only \$14 million made to date.

We believe the solution to this problem lies in an immediate increase in provisional payments to an aggregate of \$85 million. We understand the Department of the Navy plans to settle the majority of these claims during the last three months of 1970 which

The Honorable David Packard

March 2, 1970

should permit the payment of the balance of the amounts due Lockheed Shipbuilding and Construction Company by the end of this year. Should there be any delay in the Navy's present schedule an additional amount of provisional payments would be required. Immediately increasing provisional payments to \$85 million would substantially ease the financial burden of the Shipbuilding Company and permit continued work toward the completion of the DE 1052 and LPD class ships now in process. In addition, arrangements can be made which will not impair the rights of either Lockheed Shipbuilding and Construction Company or the Navy with respect to negotiation and final settlement of these claims.

AH-56A, Phase III

On May 19, 1969, the Army Contracting Officer issued a final decision terminating this letter contract for default. Lockheed's appeal from this decision was made to the ASBCA on May 22, 1969, and both Lockheed and the Army are proceeding in accordance with the rules of the Board. It is unlikely that the Board will hear this case before midyear and that a final decision can be made before the first quarter of 1971. As of the end of 1969, total costs incurred by Lockheed (both prior and subsequent to the Contracting Officer's decision) amount to approximately \$89 million. Prior to the Contracting Officer's decision the Army had made progress payments amounting to \$53.8 million. We have reached an agreement with the Army under which these progress payments may be retained by us pending a decision by the ASBCA. However, during the early part of 1970, costs incurred may reach a total of some \$110 million requiring a total cost participation by Lockheed of some \$60 to \$65 million which may be increased by the necessity of payment by Lockheed to subcontractors of additional amounts. We suggest that the Army increase the amount of progress payments to a minimum of 90% of the costs incurred, and continue such payments until resolution of this case by the Board of Contract Appeals or the Court of Claims. The same agreement under which Lockheed is currently retaining the \$53.8 million, or progress payments could apply to these additional provisional payments.

SRAM

The Lockheed Propulsion Company is the propulsion system subcontractor to the Boeing Company under its prime contract with the Air Force for DDT&E of the Short Range Attack Missile (AGM-69A). On December 29, 1969, Lockheed Propulsion Company and the Boeing Company presented a Contract Adjustment Claim to the Air Force under Contract AF 33(657)-16584 in the amount of \$50 million. At the present time, Lockheed Propulsion Company is continuing its performance of its subcontract and has incurred costs approximating \$30 million in excess of the \$16.9 million received to date. Continued performance during 1970 is expected to add more than \$15 million. Negotiations of the issues involved in our claim are currently being sought jointly by Lockheed Propulsion Company and Boeing with the Air Force. It is possible that most or all of the issues will become the subject of an ASBCA case in the next

The Honorable David F. Ford

March 2, 1970

few months. We believe that a provisional payment to Lockheed Propulsion Company of \$25 million should be authorized under the Boeing prime contract pending final resolution of the issues. As is the case with the AH-56A and the C-5 programs, suitable arrangements protecting the rights of both parties could be arranged.

In summary, in the absence of prompt negotiated settlements there is a critical need for interim financing to avert impairment of continued performance. We urgently solicit the assistance of the Department of Defense in providing such financing.

Very truly yours,

LOCKHEED AIRCRAFT CORPORATION

A handwritten signature in black ink, appearing to read "D. J. Haughton", written over a horizontal line.

D. J. Haughton  
Chairman of the Board

SECTION 504

PUBLIC LAW 91-441

OCTOBER 7, 1970

Sec. 504. (a) Of the total amount authorized to be appropriated by this Act for the procurement of the C-5A aircraft, \$200,000,000 of such amount may not be obligated or expended until after the expiration of 30 days from the date upon which the Secretary of Defense submits to the Committees on Armed Services of the Senate and the House of Representatives a plan for the expenditure of such \$200,000,000. In no event may all or any part of such \$200,000,000 be obligated or expended except in accordance with such plan.

(b) The \$200,000,000 referred to in subsection (a) of this section, following the submission of a plan pursuant to such subsection, may be expended only for the reasonable and allocable direct and indirect costs incurred by the prime contractor under a contract entered into with the United States to carry out the C-5A aircraft program. No part of such amount may be used for—

- (1) direct cost of any other contract or activity of the prime contractor;
- (2) profit on any materials, supplies, or services which are sold or transferred between any division, subsidiary, or affiliate of the prime contractor under the common control of the prime contractor and such division, subsidiary, or affiliate;
- (3) bid and proposal costs, independent research and development costs, and the cost of other similar unsponsored technical effort; or
- (4) depreciation and amortization costs on property, plant, or equipment.

Any of the costs referred to in the preceding sentence which would otherwise be allocable to any work funded by such \$200,000,000 may not be allocated to other portions of the C-5A aircraft contract or to any other contract with the United States, but payments to C-5A aircraft subcontractors shall not be subject to the restrictions referred to in such sentence.

(c) Any payment from such \$200,000,000 shall be made to the prime contractor through a special bank account from which such contractor may withdraw funds only after a request containing a detailed justification of the amount requested has been submitted to and approved by the contracting officer for the United States. All payments made from such special bank account shall be audited by the Defense Contract Audit Agency of the Department of Defense and, on a quarterly basis, by the General Accounting Office. The Comptroller General shall submit to the Congress not more than thirty days after the close of each quarter a report on the audit for such quarter performed by the General Accounting Office pursuant to this subsection.

(d) The restrictions and controls provided for in this section with respect to the \$200,000,000 referred to in subsections (a) and (b) of this section shall be in addition to such other restrictions and controls as may be prescribed by the Secretary of Defense or the Secretary of the Air Force.



THE DEPUTY SECRETARY OF DEFENSE  
WASHINGTON, D. C. 20301

DEC 30 1970

Honorable John Stennis  
Chairman, Senate Armed  
Services Committee  
United States Senate  
Washington, D. C. 20510

Dear Mr. Chairman:

As you know, on March 2, 1970, Mr. Daniel Haughton, Chairman of the Board of Lockheed Aircraft Corporation, submitted a letter to the Department of Defense citing his company's contractual and financial problems on four major defense programs: Navy shipbuilding, the SRAM Missile Motor, the Cheyenne helicopter, and the C-5A. Mr. Haughton's letter asserted that "the unprecedented dollar magnitude" of the claims and disputes in which these programs were then involved would "make it financially impossible for Lockheed to complete performance of these programs if we must await the outcome of litigation before receiving further financing from the Department of Defense." Mr. Haughton emphasized the urgent need for a settlement, or for some viable alternative to our procedure of requiring a contractor to continue performance with its own financing during resolution of disputed matters.

Immediately upon receiving this letter, the Department of Defense undertook an intensive independent determination of the nature and magnitude of the managerial and financial problems presented by Mr. Haughton's letter. Each of the military departments undertook to negotiate settlements of their individual programs. My staff compiled and analyzed data relating to the total corporate entity, including corporate financial forecasts prepared by Lockheed at our request and audited by the Defense Contract Audit Agency. It was necessary to determine the financial viability of the corporation and to examine the availability of commercial credit to meet the company's obligations.

Of utmost importance was our need to assure the continued availability of weapons systems urgently needed for our national security. Several programs for which Lockheed Aircraft Corporation is a contractor with the Department of Defense are particularly critical to the nation's defense.

### APPENDIX III

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These include the Poseidon missile system, the S-3A aircraft, the Cheyenne helicopter, and the C-5A aircraft. In addition, it clearly is in the vital national defense interest that the Navy ships currently being built under contract with the corporation be continued to completion.

The time has now come when we must move promptly toward a settlement of Lockheed-DoD contract disputes at minimum cost to the U. S. Government and with minimum impact on third parties such as Lockheed employees, suppliers, subcontractors and their employees.

It is my responsibility as Deputy Secretary of Defense to seek and to find a solution. I have learned over the years that prolonged procrastination in the face of difficult problems is an unsatisfactory stance that too often brings not solutions but added problems. Nothing is to be gained by wishing that these problems which arose in the past would go away; instead we must face present facts and move on to future needs. I therefore wish to present to you, as I promised to do, my plan to resolve these disputes.

To briefly recap, the defense contracts which have contributed to Lockheed's financial problem were executed before this administration took office. The C-5A contract was awarded to Lockheed in October 1965. The supplemental agreement to the contract, which committed funds for 23 additional aircraft and which is claimed by Lockheed to have exercised an option for 57 aircraft, was entered into during the last week of the previous administration. It is the principal dispute over the C-5A contract.

The contract for development of the AH-56A (Cheyenne) was awarded by the Army to Lockheed in March 1966. It contained an option for production quantities which was exercised in January 1968.

The contract for the SRAM missile development was awarded to Boeing in November 1966, with Lockheed participating as the subcontractor for the rocket motor.

The nine Navy ship contracts out of which Lockheed's claims arose were awarded to Lockheed from 1961 through 1965.

Shortly after taking office in January 1969, Secretary Laird and I became aware of the difficulties being encountered on these programs.

In fact, the problems we found in connection with these programs led to re-examination of and changes in the weapons acquisition process to bring both technical and cost problems under better control.

We re-evaluated operational requirements and looked at the C-5A cost growth in view of our budgetary constraints and decided not to extend that program beyond the 81 aircraft on order. Because of unresolved technical problems and a general failure to make progress, we made the decision to terminate the Cheyenne production contract for default. On the SRAM, we responded to technical and cost problems in development by not exercising our option for production and by continuing the emphasis on testing and development.

Since last March we have been working on a virtually daily basis on resolution of these Lockheed claims and disputes. Numerous discussions also have been held with the banking community on future financing needs of the corporation.

Our review established that normal procedures for resolving these disputes would require an extended period of time for which Lockheed would have insufficient cash and inadequate commercial credit to finance the continued operation of vital defense programs. We also found that without the provision of additional funds by the Department of Defense and without continued bank support, bankruptcy of the Lockheed Corporation was and is inevitable. It was then necessary to determine whether bankruptcy and corporate reorganization under the Bankruptcy Act was or was not in the interest of national defense. We found that while such bankruptcy proceedings would, if instituted, primarily apply to Lockheed, that company's operations are so entwined with many other companies which also contribute to our national defense effort that it was necessary for us to consider the chain reaction upon other companies as well. Based on extensive discussions with bankers and other defense contractors, I have concluded that the consequences of Lockheed bankruptcy at this time would be so far-reaching that several other defense suppliers would be placed in such a precarious financial condition that their capability for future operations would be jeopardized. Further, several senior members of the banking community have advised me that bankruptcy of Lockheed now would cause them to reassess their credit agreements with many other companies which supply essential defense equipment.

## APPENDIX III

Page 4

The exact ramifications of a bankruptcy proceeding remain uncertain, but, in my judgment, the potential consequences are of such a grave nature that all reasonable steps should be taken to avoid precipitating a bankruptcy by our actions on defense programs. In the event of Lockheed's bankruptcy, the Department of Defense would be faced with substantial uncertainties and risks about the degree to which several key national defense programs would or could be continued. Decisions on such matters would be subject to the discretion of the bankruptcy court, which would be required to take into consideration the interests of all creditors of the corporation. Serious delays would necessarily ensue. At a minimum, it is almost certain that an accommodation would have to be reached with the bankruptcy court to arrange to continue performance of the C-5A contract, among others, and I see no way which such an accommodation would enable the Department of Defense to obtain the C-5A and other needed equipment at a cost lower than under the course I am recommending.

With this background on the disputes and my judgment regarding bankruptcy, I want to provide the Committee my plan.

I want to make it quite clear in presenting this plan that, while we have had access to extensive financial data prepared by Lockheed and audited by the DCAA, we have only recently received Lockheed's current formal financial submittals. The plan I am proposing, therefore, is contingent upon Lockheed's being completely responsive to our continuing data requirements and our satisfactory analysis and audit of the data submitted.

I have concluded that our normal, established procedures are adequate to resolve two of the four issues.

On the SRAM, for which Lockheed is a subcontractor, the Air Force through its established procedures has negotiated a settlement with Boeing (the prime contractor). Twenty million dollars was paid in full settlement of the \$54 million claim which Boeing submitted on behalf of Lockheed. This settlement specifically provided that the entire \$20 million would be applied to increase the ceiling price of Lockheed's subcontract. This problem can therefore be considered resolved.

Ship claims of \$46 million for work under five completed contracts were settled for \$17.9 million in June of 1970. This settlement was reached through the established procedures for negotiating ship claims. The remaining claims, totaling \$159.8 million have been the subject of intensive negotiations between the Navy and Lockheed. To settle these

claims, the Navy has offered Lockheed \$58 million. I am hopeful that a settlement of these claims can be reached. Generally speaking, all negotiations regarding this program have also been concluded. The single remaining issue is Lockheed's acceptance of this offer.

The two remaining issues, therefore, are the Cheyenne program for the Army and the C-5A for the Air Force.

With regard to the Cheyenne program, it is my decision that it is in the best interest of the government to complete the development effort so that we can determine whether the Cheyenne will be a viable candidate to provide close air support for the Army, and so that we can realize some value from the investment we have already made. The ceiling price of the existing contract is approximately \$95 million, of which about \$90 million has already been disbursed by the Army. In an attempt to complete the development program, Lockheed has expended to date substantially more than the ceiling price and about \$100 million more than it has been reimbursed. We believe that a realigned development program can be completed largely within the next year, but we have concluded that the company lacks the capacity to finance this program to a point of completion satisfactory for the Army to determine the aircraft system feasibility.

For this reason, we propose to convert the Cheyenne research and development contract to a cost reimbursement form effective as of December 29, 1969. The designation of the effective date is based on an evaluation of all the relevant factors bearing on the program and upon analysis of Lockheed's overall financial condition, as shown by data received from Lockheed to date. Under this arrangement, the Army will assume future costs of the program and will reimburse Lockheed for approximately \$25 million in costs which have been incurred on the development program since December 29, 1969.

The Cheyenne production "letter contract" which was executed by the Army in January 1968, and terminated for default in May 1969, is now in the early stages of litigation. Lockheed's costs for this phase of the program approximate \$98 million against which they received \$53.8 million from the Army in progress payments prior to default. Suppliers and subcontractors for the Cheyenne production program have submitted settlement proposals in excess of \$84 million.

We have decided to settle the Cheyenne production contract by authorizing the Army to pay \$36 million or the actual amount of the settlement of the claims of unpaid suppliers and subcontracts under this letter contract, whichever is lesser. The settlement agreement will include controls and audit procedures to assure that any funds actually paid will be used solely for this purpose. The Army will audit and monitor the settlement of the claims of suppliers and subcontractors before payment. Lockheed, pursuant to this settlement, will have to agree to withdraw from litigation their related claim now before the Armed Services Board of Contract Appeals.

On the C-5A program I have, after the most careful consideration of all relevant factors, narrowed the range for resolution to two alternatives.

1. One alternative is to reduce the number of peripheral issues in dispute by negotiation and to allow the core of the disagreements to proceed through litigation. The litigation would be basically concerned, therefore, with the question of whether the Air Force exercised an option for 81 airplanes or for 115 airplanes and the corresponding application of the repricing formula. The Air Force and Lockheed, over several weeks of discussion, have concluded that the litigable disagreements would result in a financial range from approximately a plus \$25 million recovery by Lockheed against the United States to about \$480 million liability or loss by Lockheed.

2. The other alternative would settle the entire dispute by eliminating all issues and imposing a fixed loss on Lockheed. In addition, such a settlement would preclude any performance incentive fees, or profits on initial spares and on added work related to the scope of the contract which Lockheed otherwise might have earned.

Our analysis of Lockheed's financial situation has led us to the conclusion that after the Air Force has paid Lockheed up to the Air Force's interpretation of ceiling price, the company will lack the funds or resources to finance continued production of the C-5A program. Moreover, under either alternative we must achieve a workable contractual arrangement

which will permit the Air Force a more active role in management of the program. Also, under either alternative, it will be necessary for the Air Force to provide all the funds to complete the C-5A program. (Although, under the first alternative a portion may-- and under the second alternative a portion would--be repayable to the Air Force.) In any event, stipulations under either alternative would include a repayment provision and interest charges on the unpaid balances, with an acceleration clause in the event of initiation of bankruptcy.

A fixed loss settlement alternative would remove once and for all the contentions of both parties. Such fixed settlement loss would consist entirely of "allowable" costs, and would be above and in addition to losses due to certain costs incurred by the contractor which are neither allowed nor paid by the government. (These costs, referred to as "unallowables," are projected by Lockheed to exceed \$40 million on this program. In addition, payments to Lockheed will exclude otherwise allowable costs to the extent such costs fall in the four numbered categories listed in Section 504(b) of the Department of Defense Procurement and Research Authorization Act, 1971 (P. L. 91-241).)

In determining the dollar amount of the fixed loss that should be the basis for the settlement of the C-5A dispute, I took all relevant factors into consideration. Among the factors considered in arriving at this figure were the range of financial results which would result from the litigation, the apparent weight of the legal arguments of the parties on the issues in dispute and Lockheed's potential ability to respond to a judgment in favor of the United States, should one result. After weighing all the many complex factors, a \$200 million figure represents my best judgment. I do not expect it to meet with unanimous endorsement; some will think it too low, others too high--but it remains my best judgment after months of consideration of what is without doubt the most complex management and contractual dispute I or any of the principals ever have encountered.

After weighing both of these alternatives I have concluded that the fixed loss settlement alternative is preferable. It has the advantage of finality, and would facilitate management improvements in the remainder of the program. I recognize the possibility that Lockheed may decline to settle for this fixed loss and prefer litigation.

As I mentioned earlier, Lockheed's latest financial information is being compiled and will be audited by the Defense Contract Audit Agency. We

have also asked that the General Accounting Office review this data with us prior to the execution of our decisions.

The \$200 million "contingency" fund, which we have requested to be authorized and appropriated for FY 1971 for the C-5A, will necessarily be utilized to continue the production of the aircraft beginning in February, and will be expended in the context of the settlement outlined above.

We are aware that the course of action which we propose to follow does not guarantee that bankruptcy of Lockheed is precluded; nevertheless, this course is, in our opinion, the necessary one based on the national defense interest. The uncertainty exists because overall financial stability of Lockheed is contingent not only on the financing of its defense programs, but also on further financial support from the private sector for its commercial programs, particularly the L-1011 airbus.

Our actions in settling the disputes on the four defense programs will resolve contingent liabilities of Lockheed and, we hope, thereby provide a degree of certainty to the overall financial affairs of Lockheed that will permit the banks to continue to finance the commercial programs, and avoid bankruptcy. I will continue to closely monitor the financial and management situation of Lockheed as these plans are implemented. It is also my intent to insure that all possible controls are exercised by Defense over our financial relationships with Lockheed to assure the satisfactory performance on Defense programs and the protection of Defense interests.

This summarizes the alternatives and the action we intend to take to resolve these very difficult contractual matters. The final details of the settlement and the documents necessary to implement this plan are now being prepared, and will be completed by the end of January 1971.

I will be available to review this plan in detail with your Committee at your convenience, and will be glad to have your views on the alternatives.

Sincerely,

A handwritten signature in black ink, appearing to read "Ronald Reagan", written in a cursive style.



THE DEPUTY SECRETARY OF DEFENSE  
WASHINGTON, D. C. 20301

FEB 2 1971

Honorable John Stennis  
Chairman, Senate Armed  
Services Committee  
United States Senate  
Washington, D. C. 20510

Dear Mr. Chairman:

This is in further response to your request for additional information in connection with the plan I described to you in my letter of December 30, 1970 for the resolution of the contract disputes between the Department of Defense and the Lockheed Aircraft Corporation and for the expenditure of the \$200 million authorized for appropriation by Public Law 91-441 which is subject to the provisions of section 504 therein.

I am enclosing herewith additional information concerning the detailed procedures to be employed by the Department of the Air Force in making payments from those funds.

If I can be of any further assistance, please let me know.

Sincerely,

A handwritten signature in dark ink, appearing to be "D. R. ...", written over the word "Sincerely,".

Enclosure

FOR OFFICIAL USE ONLY

AIR FORCE PROCEDURES FOR MAKING PAYMENT UNDER  
THE RESTRICTIONS OF  
SECTION 504, PUBLIC LAW 91-441

The Air Force intends to initiate obligations from the \$200 million contingency fund (hereinafter referred to as the "contingency fund") provided for in Section 504 approximately Mid-May 1971 to provide expenditure authority to allow payments to be made for work called for by the C-5A restructured contract. It is anticipated that by said date the estimated Lockheed portion of the C-5A program included in the Fiscal Year 1971 appropriation (other than the contingency fund) and applicable prior year appropriations will have been made available for the current contract or the restructured contract. The procedures prescribed herein are in implementation of Section 504 and will apply to payments made from the contingency fund and shall apply to any other payments made under the restructured C-5A contract with Lockheed from and after the date of initiation of payments from the contingency fund. The implementation of these procedures will be accomplished by appropriate provisions included in the restructured C-5A contract. Payments will be made in accordance therewith.

In order to insure that the restrictions and limitations contained in Section 504 are complied with in respect to the contingency fund and to funds hereafter made available to the C-5A restructured contract, the following actions will be taken:

1. The contract will provide that no direct costs on any other contract or activity of the prime contractor will be allowable costs under the C-5A restructured contract.
2. The contract will provide that no profit on any materials, supplies, or services which are sold or transferred between any division, subsidiary, or affiliate of Lockheed under the common control of Lockheed or such division, subsidiary, or affiliate, will be an allowable cost to be paid out of said contingency fund and funds hereafter made available for payment under the contract and such disallowed profit will not be recouped under any other contract with the Government.

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3. The contract will also provide that bid and proposal costs, independent research and development costs, the costs of other similar unsponsored technical effort, and depreciation and amortization costs on property, plant, or equipment of the contractor, as determined by negotiation between the contractor and the Government and which would otherwise be allocable to work funded by said contingency fund and by funds made available hereafter for payment under the contract, will not be allowed under that contract and such disallowed cost will not be recouped under any other contract with the Government.

In order to accomplish the actions called for by subparagraph 3 above, special billing rates will be established which will be lower than the generally applicable cost reimbursement rates. These special billing rates will be designed to exclude the unallowable costs specified in subparagraph 3 above. The final negotiated overhead rates; i. e., those based on the actual costs for overhead for 1971, will then be adjusted to reflect the exclusion of the actual unreimbursable costs referred to above. The contract will provide that such unallowable overhead costs will be excluded commencing with the obligation of the contingency fund.

4. a. A Special Bank Account, as prescribed by Section 504(c) will be established. This will be an agreement between the Air Force, Lockheed Aircraft Corporation and the bank selected to maintain the Special Bank Account. It will prescribe: (1) All payments made pursuant to Section 504 and from funds subsequently appropriated shall be made into the Special Bank Account; (2) The Government shall have a lien upon the balance of the account; (3) The limitations of the bank's liability in connection with the account; (4) The specific procedures for withdrawal of funds from the account; and (5) The right of the Government to inspect the bank's records of such account.

b. In order to make the Special Bank Account operative within the C-5A contract structure, certain new provisions will be required in the restructured C-5A contract. These proposed provisions will provide for (a) the establishment of the account, (b) the use of the funds in the Special Bank Account, (c) the method of withdrawal of funds from the account, (d) the Government's right to the balance in the account in the event of bankruptcy or other adverse actions against the contractor, and

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(c) the prohibition against assignment of the contract to any other parties and subordination of any assignments previously made.

c. The Special Bank Account will be established in a commercial bank. Lockheed will be asked to designate a bank located in the Atlanta, Georgia, area as mutually agreed upon by the Contracting Officer for this purpose and the Special Bank Account will be designated "Lockheed-Georgia Company/Air Force Special Bank Account." Payments to Lockheed will be processed as set forth below:

d. All requests for payment will be sent to the Administrative Contracting Office (ACO) for approval. The ACO will exclude costs which are held to be unallowable under the limitations and restrictions specified in Section 504 prior to approval and forwarding to the Disbursing Officer designated to make payments under the contract.

e. The Disbursing Officer will set up a separate record to control all expenditures from the contingency fund. Upon receipt of the approved payment request and after determining that it is a proper charge, the Disbursing Officer will issue a check in payment of the amount made to the order of "Lockheed-Georgia Company/Air Force Special Bank Account." This check will then be deposited in the Special Bank Account.

f. Withdrawals from the Special Bank Account will require the signature of both the contractor and the Contracting Officer. Section 504 requires that these funds "be expended only for the reasonable and allocable direct and indirect costs incurred by the prime contractor... to carry out the C-5A aircraft program." To satisfy this requirement and the provisions of the restructured contract, it will be necessary for Lockheed to submit a detailed justification to the ACO to support requests for withdrawal of funds from this Special Bank Account. Withdrawals from the Special Bank Account will normally be related to vouchers which formed the basis for the deposit in the Special Bank Account. Lockheed's detailed justification will usually be submitted weekly in the form of a listing of payrolls, material receipts/invoices and other costs which have been incurred in support of the C-5A program, and which are due for payment during a reasonable period of time. After review of this justification, the ACO will determine the amount of funds which may properly be released from the Special Bank Account to Lockheed's general bank account. The contractor will then pay its creditors and employees by drawing checks on its general bank account.

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g. Section 504(c) provides that "all payments made from such bank account shall be audited by the Defense Contract Audit Agency..." and the terms of the restructured contract will likewise so require during the performance thereof. To avoid any undue delays in releasing cash from the Special Bank Account, DCAA audits will generally be conducted after the ACO has approved the voucher or detailed justification for withdrawal of funds. The ACO may request a DCAA audit prior to approval of any payment if he believes a significant portion of the voucher submission is questionable. If any audit adjustments are indicated, cost offsets will be made by the ACO against current or future vouchers or requests for withdrawals submitted by Lockheed.

h. Section 504(c) provides that "all payments made from such Special Bank Account shall be audited... on a quarterly basis, by the General Accounting Office. The Comptroller General shall submit to the Congress not more than thirty days after the close of each quarter a report on the audit for such quarter performed by the General Accounting Office pursuant to the subsection." The Air Force will cooperate fully with the GAO in the accomplishment of its audit.

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APPENDIX V

STATUS OF FUNDING FOR C-5A AIRCRAFT PROGRAM

	Program year	Appro- priated	Repro- gramming (+ or -)	Current program	Obligated	Expended
(millions)						
<b>RDT&amp;E</b>						
	1971	\$ 11.6	\$ -	\$ 11.6	\$ 2.3	\$ 0.2
	1970	34.2	-	34.2	30.9	24.0
	1969	128.0	-2.0	126.0	124.8	120.7
	1968	305.2	+36.7	341.9	341.5	340.9
	1967	258.2	+20.4	278.6	277.8	277.8
	1966	157.0	+1.9	158.9	158.7	154.7
	1965	7.0	+35.0	42.0	42.0	42.0
	1964	-	+10.0	10.0	10.0	10.0
	<b>Total</b>	<b>901.2</b>	<b>+102.0</b>	<b>1,003.2</b>	<b>988.0</b>	<b>970.3</b>
<b>Procurement (In- cluding initial spares)</b>						
	1971	609.2	-	609.2	400.2	350.9
	1970	865.8	-	865.8	677.8	576.0
	1969	625.9	-	625.9	604.4	538.9
	1968	492.8	+16.6	509.4	504.3	482.6
	1967	415.3	-20.1	395.2	392.7	393.1
	<b>Total</b>	<b>3,009.0</b>	<b>-3.5</b>	<b>3,005.5</b>	<b>2,579.4</b>	<b>2,341.5</b>
<b>Construction</b>						
	1971	1.3		1.3	-	
	1970	9.4		9.4	7.5	.8
	1969	.1		.1	.1	.1
	1968	6.8	-	6.8	6.8	6.8
	<b>Total</b>	<b>17.6</b>	<b>-</b>	<b>17.6</b>	<b>14.4</b>	<b>7.7</b>
	<b>Total</b>	<b>\$3,927.8</b>	<b>\$ 98.5</b>	<b>\$4,026.3</b>	<b>\$3,581.8</b>	<b>\$3,319.5</b>

Note: The total amount shown as expended is as of December 31, 1970.

Public Law 85-804  
(as amended)  
50 U.S.C. 1431 - 1435

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the President may authorize any department or agency of the Government which exercises functions in connection with the national defense, acting in accordance with regulations prescribed by the President for the protection of the Government, to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense. The authority conferred by this section shall not be utilized to obligate the United States in an amount in excess of \$50,000 without approval by an official at or above the level of an Assistant Secretary or his Deputy, or an assistant head or his deputy, of such department or agency, or by a Contract Adjustment Board established therein.

SEC. 2. Nothing in this Act shall be construed to constitute authorization hereunder for--

(a) the use of the cost-plus-a-percentage-of-cost system of contracting;

(b) any contract in violation of existing law relating to limitation of profits;

(c) the negotiation of purchases of or contracts for property or services required by law to be procured by formal advertising and competitive bidding;

(d) the waiver of any bid, payment, performance, or other bond required by law;

(e) the amendment of a contract negotiated under section 2304(a)(15), title 10, United States Code, or under section 302(c)(13) of the Federal Property and Administrative Services Act of 1949, as amended (63 Stat. 377,394), to increase the contract price to an amount higher than the lowest rejected bid of any responsible bidder; or

(f) the formalization of an informal commitment, unless it is found that at the time the commitment was made it was impracticable to use normal procurement procedures.

SEC. 3 (a) All actions under the authority of this Act shall be made a matter of public record under regulations prescribed by the President and when deemed by him not to be detrimental to the national security.

(b) All contracts entered into, amended, or modified pursuant to authority contained in this Act shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years

after final payment, have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or subcontracts. Under regulations to be prescribed by the President, however, such clauses may be omitted from contracts with foreign contractors or foreign subcontractors if the agency head determines, with the concurrence of the Comptroller General of the United States or his designee, that the omission will serve the best interests of the United States. However, the concurrence of the Comptroller General of the United States or his designee is not required for the omission of such clause -

(1) where the contractor or subcontractor is a foreign government or agency thereof or is precluded by the laws of the country involved from making its books, documents, papers, or records available for examination; and

(2) where the agency head determines, after taking into account the price and availability of the property or services from United States sources, that the public interest would be best served by the omission of the clause.

If the clause is omitted based on a determination under clause (2), a written report shall be furnished to the Congress.

SEC. 4 (a) Every department and agency acting under authority of this Act shall, by March 15 of each year, report to Congress all such actions taken by that department or agency during the preceding calendar year. With respect to actions which involve actual or potential cost to the United States in excess of \$50,000, the report shall --

- (1) name the contractor;
- (2) state the actual cost or estimated potential cost involved;
- (3) describe the property or services involved; and
- (4) state further the circumstances justifying the action taken.

With respect to (1), (2), (3), and (4), above, and under regulations prescribed by the President, there may be omitted any information the disclosure of which would be detrimental to the national security.

(b) The Clerk of the House and the Secretary of the Senate shall cause to be published in the Congressional Record all reports submitted pursuant to this section.

SEC. 5. This Act shall be effective only during a national emergency declared by Congress or the President and for six months after the termination thereof or until such earlier time as Congress, by concurrent resolution, may designate."

Executive Order No. 10789  
of November 14, 1958 (23 Fed. Reg. 8897)  
As Amended by Executive Order 11051,  
dated September 27, 1962

AUTHORIZING AGENCIES OF THE GOVERNMENT TO EXERCISE CERTAIN CONTRACTING  
AUTHORITY IN CONNECTION WITH NATIONAL DEFENSE FUNCTIONS AND PRESCRIBING  
REGULATIONS GOVERNING THE EXERCISE OF SUCH AUTHORITY

By virtue of the authority vested in me by the act of August 28, 1958, 72 Stat. 972, hereinafter called the act, and as President of the United States, and in view of the existing national emergency declared by Proclamation No. 2914 of December 16, 1950, and deeming that such action will facilitate the national defense, it is hereby ordered as follows:

Part I--Department of Defense

Under such regulations, which shall be uniform to the extent practicable, as may be prescribed or approved by the Secretary of Defense:

1. The Department of Defense is authorized, within the limits of the amounts appropriated and the contract authorization provided therefor, to enter into contracts and into amendments or modifications of contracts heretofore or hereafter made, and to make advance payments thereon, without regard to the provisions of law relating to the making, performance, amendment, or modification of contracts, whenever, in the judgment of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, or the duly authorized representative of any such Secretary, the national defense will be facilitated thereby.

2. The Secretaries of Defense, the Army, the Navy, and the Air Force, respectively, may exercise the authority herein conferred and, in their discretion and by their direction, may delegate such authority to any other military or civilian officers or officials of their respective departments, and may confer upon any such military or civilian officers or officials the power to make further delegations of such authority within their respective commands or organizations: Provided, that the authority herein conferred shall not be utilized to obligate the United States in an amount in excess of \$50,000 without approval by an official at or above the level of an Assistant Secretary or his Deputy, or by a departmental Contract Adjustment Board.

3. The contracts hereby authorized to be made shall include agreements of all kinds (whether in the form of letters of intent, purchase orders, or otherwise) for all types and kinds of property or services necessary, appropriate, or convenient for the national defense, or for the invention, development, or production of, or research concerning, any such property or services, including, but not limited to, aircraft, missiles, buildings, vessels, arms, armament, equipment or

supplies of any kind, or any portion thereof, including plans, spare parts and equipment therefor, materials, supplies, facilities, utilities, machinery, machine tools, and any other equipment without any restriction of any kind as to type, character, location, or form.

4. The Department of Defense may by agreement modify or amend or settle claims under contracts heretofore or hereafter made, may make advance payments upon such contracts of any portion of the contract price, and may enter into agreements with contractors or obligors modifying or releasing accrued obligations of any sort, including accrued liquidated damages or liability under surety or other bonds. Amendments or modifications of contracts may be with or without consideration and may be utilized to accomplish the same things as any original contract could have accomplished hereunder, irrespective of the time or circumstances of the making, or the form, of the contract amended or modified, or of the amending or modifying contract, and irrespective of rights which may have accrued under the contract or the amendments or modifications thereof.

5. Proper records of all actions taken under the authority of the act shall be maintained within the Department of Defense. The Secretaries of Defense, the Army, the Navy, and the Air Force shall make such records available for public inspection except to the extent that they, or their duly authorized representatives, may respectively deem the disclosure of information therein to be detrimental to the national security.

6. The Department of Defense shall, by March 15 of each year, report to the Congress all actions taken within that department under the authority of the act during the preceding calendar year. With respect to actions which involve actual or potential cost to the United States in excess of \$50,000, the report shall (except as the disclosure of such information may be deemed to be detrimental to the national security)--

- (a) name the contractor;
- (b) state the actual cost or estimated potential cost involved;
- (c) describe the property or services involved; and
- (d) state further the circumstances justifying the action taken.

7. There shall be no discrimination in any act performed hereunder against any person on the ground of race, religion, color, or national origin, and all contracts entered into, amended, or modified hereunder shall contain such nondiscrimination provision as otherwise may be required by statute or Executive order.

8. No claim against the United States arising under any purchase or contract made under the authority of the act and this order shall be assigned except in accordance with the Assignment of Claims Act of 1940 (54 Stat. 1029), as amended.

9. Advance payments shall be made hereunder only upon obtaining adequate security.

10. Every contract entered into, amended, or modified pursuant to this order shall contain a warranty by the contractor in substantially the following terms:

The Contractor warrants that no person or selling agency has been employed or retained to solicit or secure this contract upon an agreement or understanding for a commission, percentage, brokerage, or contingent fee, except bona-fide employees or bona-fide established commercial or selling agencies maintained by the Contractor for the purpose of securing business. For breach or violation of this warranty the Government shall have the right to annul this contract without liability or, in its discretion, to deduct from the contract price or consideration, or otherwise recover, the full amount of such commission, percentage, brokerage, or contingent fee.

11. All contracts entered into, amended, or modified pursuant to authority of this order shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment, have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of, and involving transactions related to, such contracts or subcontracts.

12. Nothing herein contained shall be construed to constitute authorization hereunder for--

- (a) the use of the cost-plus-a-percentage-of-cost system of contracting;
- (b) any contract in violation of existing law relating to limitation or profits or fees;
- (c) the negotiation of purchases of or contracts for property or services required by law to be procured by formal advertising and competitive bidding;
- (d) the waiver of any bid, payment, performance, or other bond required by law;
- (e) the amendment of a contract negotiated under section 2304(a) (15) of title 10 of the United States Code to increase the contract price to an amount higher than the lowest rejected bid of any responsible bidder; or
- (f) the formalization of an informal commitment, unless the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, or the duly authorized representative of any such Secretary, finds that at the time the commitment was made it was impracticable to use normal procurement procedures.

13. The provisions of the Walsh-Healey Act (49 Stat. 2036), as amended, the Davis-Bacon Act (49 Stat. 1011), as amended, the Copeland Act (48 Stat. 948), as amended, and the Eight Hour Law (37 Stat. 137), as amended, if otherwise applicable, shall apply to contracts made and performed under the authority of this order.

14. Nothing herein contained shall prejudice anything heretofore done under Executive Order No. 9001 of December 27, 1941, or Executive Order No. 10210 of February 2, 1951, or any amendments or extensions thereof, or the continuance in force of an action heretofore taken under those orders or any amendments or extensions thereof.

15. Nothing herein contained shall prejudice any other authority which the Department of Defense may have to enter into, amend, or modify contracts, and to make advance payments.

Part II--Extension of Provisions of Paragraphs 1-14

21. Subject to the limitations and regulations contained in paragraphs 1 to 14, inclusive, hereof, and under any regulations prescribed by him in pursuance of the provisions of paragraph 22 hereof, the head of each of the following-named agencies is authorized to perform or exercise as to his agency, independently of any Secretary referred to in the said paragraphs 1 to 14, all the functions and authority vested by those paragraphs in the Secretaries mentioned therein:

- Department of the Treasury
- Department of the Interior
- Department of Agriculture
- Department of Commerce
- Department of Transportation
- Atomic Energy Commission
- General Services Administration
- National Aeronautics and Space Administration
- Tennessee Valley Authority
- Government Printing Office

22. The head of each agency named in paragraph 21 hereof is authorized to prescribe regulations governing the carrying out of the functions and authority vested with respect to his agency by the provisions of paragraph 21 hereof. Such regulations shall, to the extent practicable, be uniform with the regulations prescribed or approved by the Secretary of Defense under the provisions of Part I of this order.

23. Nothing contained herein shall prejudice any other authority which any agency named in paragraph 21 hereof may have to enter into, amend, or modify contracts and to make advance payments.

24. Nothing contained in this Part shall constitute authorization thereunder for the amendment of a contract negotiated under section 302(c)(14) of the Federal Property and Administrative Services Act of 1949 (63 Stat. 394), as amended by section 2(b) of the act of August 28, 1958, 72 Stat. 966, to increase the contract price to an amount higher than the lowest rejected bid of any responsible bidder.

DWIGHT D. EISENHOWER"

## LOCKHEED AIRCRAFT CORPORATION

BURBANK, CALIFORNIA 91503

January 5, 1971

The Honorable David Packard  
Deputy Secretary of Defense  
The Pentagon  
Washington, D. C. 20301

Dear Mr. Packard:

I wish to acknowledge your letter of December 30, 1970, and the copy of your letter to Senator Stennis, Chairman of the Senate Armed Services Committee. Your proposed plan of action and comments have received careful study and deliberation by our Board of Directors and management, and our response to the alternative approaches is our considered judgment on these complex and difficult matters.

While I agree with you that the time has come to move promptly toward a resolution of our disputes at minimum cost to the government and with minimum impact on third parties, such as our employees and subcontractors, I would like to think it is equally important to seek a resolution that also is fair to the more than 55,000 Lockheed shareholders.

We recognize that Lockheed's first responsibility is one we must share with the Department of Defense -- to establish contractual and working agreements that will help assure the continued delivery of defense articles that are important to our nation's security. We accept unreservedly our part of this responsibility and will cooperate fully with the DoD in finalizing such agreements.

Now I should like to respond to the various proposals as you have stated them in your letter to Senator Stennis. I want to assure you that we intend to carry out to successful completion all the programs in which Lockheed is engaged -- not only those for the government but also those for our commercial customers. We will continue to be responsive to your data requirements. And we will continue working closely with you to improve all aspects of our programs.

We agree that the \$20 million settlement we have negotiated with Boeing resolves the claim Boeing submitted to the Air Force on our behalf for the short range attack missile (SRAM) motor program.

LOOK TO LOCKHEED FOR LEADERSHIP

The Honorable David Packard

January 5, 1971

With reference to ship construction claims, we are not prepared to accept the Navy offer of \$58 million. It is our belief, however, that if both parties continue to pursue negotiations diligently a mutually acceptable solution can be achieved within a reasonable period of time.

We accept your proposals regarding the AH-56A Cheyenne development and production contracts. In consideration of the Department of Defense offer we will withdraw from litigation our claim regarding the Cheyenne production contract, although we consider that we have a sound case before the Armed Services Board of Contract Appeals challenging the default cancellation of that contract.

With regard to the C-5A you offered us two alternatives. One was to reduce the number of peripheral issues in dispute by negotiation and to allow the core of the disagreements to proceed through litigation. The other alternative was to settle the entire dispute by eliminating all issues and imposing a fixed loss on Lockheed.

Although you are familiar with the position we have taken on the C-5A contract, I should like to outline it briefly once again so that you will appreciate the reasoning behind our choice between the proposed alternatives.

We entered into the C-5A program in 1965, fully aware that it was the government's first contract under the total package procurement concept. At that time we recognized the worthwhile objective of putting the total program -- development, testing, and several years of production -- under contract at one time.

This fixed price type contract was deliberately constructed with a repricing formula designed to prevent so-called windfall profits and provide protection against catastrophic losses. This repricing formula was a necessary element of the otherwise inflexible nature of this new long term total package procurement plan. The Air Force included the repricing formula in the contract it offered to all three of the final competitors. We would not have signed the contract without this essential provision or some comparable protection.

The repricing clause has been misunderstood and in some cases distorted. It has even been falsely labeled as a "bail-out" or "get well" clause. Such charges ignore the purpose of the contract as discussed above -- that of providing for a single long term procurement and attempting to provide some sort of protection to both the government and the contractor.

You have acknowledged that your department has now discarded the total package contract as an effective procurement method. Our experience under this form of procurement on the C-5A program would certainly lead us to agree that it properly should have been abandoned. Unfortunately, Lockheed has been left with the consequences of a procurement system that has proved to be completely unworkable.

The Honorable David Packard

January 5, 1971

As finalized in December 1965 the C-5A contract was for an initial quantity of 58 aircraft with options for additional quantities. It was bilaterally amended in January 1969 by Supplemental Agreement No. 235 to exercise the option for 57 Production Run B aircraft, making it a contract for 115 aircraft. Supplemental Agreement No. 235 made other changes in the contract including establishing target and ceiling prices for 115 aircraft. This amendment brought the repricing formula into play. Congress was notified by the DoD of the option exercise.

In November 1969 the Air Force unilaterally issued Change Order No. 521 in which it said it was placing a "final order" for 23 aircraft of the 57 Production Run B aircraft which Supplemental Agreement No. 235 had already ordered by exercise of the option. Change Order No. 521 even purported to unilaterally establish new prices for an 81 aircraft contract.

In our judgment the Air Force action in issuing Change Order No. 521 constituted a partial termination of the contract for the convenience of the government. As a unilateral act the change order could not reduce the amount of the contract price adjustment to which Lockheed would be entitled under the repricing clause. We are convinced our case is a sound one based both on legal interpretation of the contract and on considerations of equity. We believe adjudication of the case should ultimately permit Lockheed to substantially recover its costs expended on the program -- with even the possibility of a profit for our nearly eight years of major effort.

Despite subsequent criticism, we believe the C-5A program has been managed well. With the benefit of hindsight, there may be a number of things we and the Air Force might have handled more effectively on the C-5A program. Costs, impressive because of the magnitude of the program, have been a difficult problem. A significant portion of the cost growth was occasioned by the inflexibility of contract terms and interpretation that prevented specification and cost trade-offs.

Neither party to the contract expected the massive escalation of the war in Southeast Asia. Neither of us forecast the uncontrolled inflation and rising costs that took place in 1965 and subsequent years. We had not anticipated the surge of commercial transport orders that affected the aerospace industry in those years, turning a buyer's market into a seller's market as we sought suppliers and subcontractors, and restricting the availability of engineers and other trained people.

Our product is a good one, needed for the security of this country. We are providing the government with an aircraft that -- almost uniquely among aircraft weapon systems -- is meeting every one of its original performance guarantees and is demonstrating exceptional capabilities in its initial year of operation.

The Honorable David Packard

January 5, 1971

In determining our response to your proposed alternatives for resolution of the C-5A disputes we have taken into consideration all the aforementioned factors. High among the factors considered were the soundness of our legal position with respect to the C-5A contract, the inequity of our being required to accept a \$200 million fixed loss to resolve all outstanding legal issues, and the responsibility we owe to our company and our shareholders.

We understand your view that the fixed loss settlement alternative is preferable since it has the advantage of finality and permits program continuation in a more favorable contractual environment. We do not consider, however, that under the circumstances of our C-5A dispute, Lockheed can accept a compromise which entails such an excessive and unwarranted penalty to Lockheed as \$200 million. We must therefore decline to settle for a fixed loss of \$200 million, and we elect to proceed with litigation in accordance with the basic guidelines posed in the first alternative in your letter. We are confident we can arrive at a satisfactory agreement with the Air Force regarding the issues to be involved in the litigation and the conduct of the litigation so as to minimize its impact on day-to-day operation of the program. The major issues remaining in litigation would include the dispute regarding option exercise and the related application of the repricing formula but would not be limited to that single issue within the financial range mentioned in your letter.

You laid particular stress upon the impact that your proposals might have upon Lockheed's financial status. It should be pointed out that we are in the process of restructuring our financial plan with our lending banks. We believe we will be successful in concluding such arrangements. In this connection your comment to Senator Stennis that "under either alternative, it will be necessary for the Air Force to provide all the funds to complete the C-5A program" and that "in any event, stipulations under either alternative would include a repayment provision and interest charges on the unpaid balances" will play an important role. It therefore becomes imperative that an understanding be arrived at promptly on the provisions for such payments, to or from Lockheed, depending on the outcome of the litigation. We shall continue to work with your office to complete these provisions.

We appreciate the thoroughness with which you have stated your position and the reasons for it. I have tried to be equally thorough in outlining the reasons behind our decision to choose the alternative of litigation of the C-5A issues.

We share your desire to finalize details of your plan of action by the end of January. We stand ready to meet with your representatives on an expedited schedule to resolve the remaining details in arriving at final solutions that may best and equitably serve all interests.

Sincerely,



D. J. Haughton  
Chairman of the Board



THE DEPUTY SECRETARY OF DEFENSE  
WASHINGTON, D. C. 20301

January 27, 1971

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Mr. D. J. Haughton  
Chairman of the Board  
Lockheed Aircraft Corporation  
Burbank, California 91503

Dear Mr. Haughton:

Your letter of January 5, 1971 relating to the methods of resolving the disputes between Lockheed and the Department of Defense on the Ship procurements, and the AH-56 (CHEYENNE) and C-5A programs has been carefully reviewed and considered.

You indicated that Lockheed had made a decision to litigate the dispute on the C-5A program, which is the right of Lockheed. You also indicated that Lockheed could not agree to limit the litigation to the single issue of the option exercise and the related application of the repricing formula, as I had contemplated in posing possible alternatives for resolution of the dispute in my letter of December 30, 1970 to the Chairmen of the Armed Services Committees of the Senate and House of Representatives.

Since receipt of your letter, considerable consideration has been given to the course of action which you propose. I have found that there is no precedent in the Department of Defense for advancing funds beyond those specified in a contract during the course of litigation between the contracting parties. After very careful evaluation of all related factors, I have determined that under such circumstances, the Department of Defense could not agree to payments to Lockheed in excess of the ceiling on the contract during the litigation process, or to restructure the existing contract. In addition, the prospect for litigation of long duration in which the issues in litigation are not limited would make extremely difficult the administration and management of the continuing program under a restructured contract. A restructured contract under such circumstances would also potentially confuse and complicate the litigation.

In the event you should decide to reconsider your decision to litigate, it would be my intent to settle the entire C-5A program dispute on the basis of Lockheed accepting a fixed loss of \$200 million for the entire program.

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The fixed loss would consist entirely of "allowable" costs, and would be above and in addition to certain costs incurred by Lockheed which are neither allowed nor paid by the Government. Under this arrangement, the existing contract would be restructured to a cost type contract. The restructured contract would, of course, exclude payment for those four categories of costs listed in section 504(b) of the Department of Defense Procurement and Research Authorization Act, 1971 (P. L. 91-441) from the point at which payments to Lockheed are commenced to be paid from the last \$200 million appropriated for the program in fiscal year 1971. Such categories of costs would also be excluded throughout the remainder of the restructured contract. It would further provide for repayment by Lockheed to the United States of that amount paid by the Air Force for allowable costs which is in excess of the amount of such costs less the \$200 million. This repayment would begin on January 1, 1974. Terms of repayment would be in line with our previous discussions, that is, the greater of \$10 million or 10% of net profits before taxes per year, with interest at the prime rate and with repayments to be adjusted upward in the event of payment of dividends by Lockheed. In the event of bankruptcy, the unpaid balance would become immediately payable. The repayment would also be secured by a lien to the Department of the Air Force on the Lockheed Marietta Plant.

This proposal is based on the assumption, of course, that the banks and Lockheed proceed to execute and carry out the latest financing plan which Lockheed and the banks have under discussion.

Should Lockheed elect to reconsider and accept this fixed loss settlement offer on the C-5A program, we would then be prepared to proceed with the resolution of the CHEYENNE program as outlined in my letter of December 30, 1970 to the Chairmen of the Armed Services Committees, of which you have a copy. Resolution of the dispute on the Ship procurements would be left to normal procedures for resolution.

Should you desire to review the details of the restructured contract which my offer contemplates for the C-5A program, we will be pleased to make it available.

Sincerely,

/s/ David Packard

## LOCKHEED AIRCRAFT CORPORATION

BUREAU, CALIFORNIA 91503

February 1, 1971

The Honorable David Packard  
Deputy Secretary of Defense  
The Pentagon  
Washington, D.C. 20301

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Dear Mr. Packard:

After careful study of your letter of January 27, 1971, we accept your proposal that the entire C-5A program dispute be settled on the basis of our absorbing a loss of \$200 million plus disallowed costs.

In my letter to you dated January 5, 1971, we chose to litigate this dispute after negotiating the issues. You have now found, however, that the Defense Department has no precedent for funding a contract during litigation. This decision places us in the position where we can exercise our right to litigate only if we provide from other sources the hundreds of millions of dollars required to fund the C-5A program for the amounts in dispute.

We made it known in my letter to you on March 2, 1970, and subsequently that Lockheed would not have the capability to fund completion of the C-5A program under the Air Force interpretation of the contract. Your January 27 letter, placing the funding requirement on Lockheed, in effect closes the door to any way in which we might pursue an appeals board or court review of the merits of the C-5A contract dispute. We also understand from your letter that only after we accept the \$200 million loss on the C-5A will you then be prepared to proceed with resolution of the Cheyenne program as offered in your letter of December 30, 1970.

Under all of these circumstances, Lockheed really has no choice. Other alternatives would jeopardize the interests of our stockholders, employees, subcontractors and suppliers, airlines and other commercial customers, the banks who have supported us and who base additional credit availability upon an agreement for resolving our disputed contracts -- and certainly the interests of the Government itself which depends upon Lockheed for continued production on programs that you have described as "particularly critical to the nation's defense."

Therefore we most reluctantly accept your requirement that we absorb a \$200 million loss on the C-5A under the guidelines in your January 27 letter. We accept the basis contained in your December 30 letter for settling the MH-56A helicopter dispute. Last week as you know we reached a tentative agreement with the Navy to resolve the ship construction claims we have submitted.

With regard to the additional disallowances of certain costs imposed by Public Law 91-441, we strongly suggest that the C-5A contractual provisions should not impose penalties beyond those required by the statute. We would appreciate an opportunity to discuss this with your staff.

APPENDIX X

Page 2

Our progress on implementing the financing plan that we and the banks now are discussing is quite satisfactory. We expect to finalize the agreement this month. However, you recognize that our ability to avail ourselves of the total credit is contingent upon our resolving our defense contract disputes.

We are prepared to meet with your representatives at your earliest convenience to negotiate final details of the restructured C-5A contract and to complete all other remaining details in regard to the C-5A and ship programs.

We hope final settlement of these disputes can be achieved very quickly. We believe we have been successful in not allowing the disputes to interfere with the manufacture and delivery of all Lockheed products and services that are important to our national security. We pledge Lockheed's full cooperation in working with the military services to meet this continuing responsibility.

Sincerely,

/s/

D. J. Houghton  
Chairman of the Board

LOCKHEED AIRCRAFT CORPORATION  
BURBANK, CALIFORNIA 91503

February 17, 1971

Mr. Milo Wietstock, Audit Manager  
U. S. General Accounting Office  
Federal Building, Room 7068  
300 North Los Angeles Street  
Los Angeles, California 90012

Dear Mr. Wietstock:

During recent discussions, you requested additional information on action taken by Lockheed management to curtail expenses and minimize cash requirements. In particular, reference was made to special efforts directed toward these objectives by Lockheed management, in recognition of the impact of potential losses which might accrue from the problem DoD programs.

Attached is a brief summary of considerations and actions of management which resulted in part from special emphasis and attention to cash conservation. However, I also would like to comment briefly on our normal program to control expenditures and cash requirements. This program, which has been utilized for many years, is based on a formal management approach to financial planning and includes a number of specific activities providing financial and management control.

For example, short term operations are based on approved management budgets which not only set forth goals for sales and profits, but also include integrated management plans for fixed asset expenditures, overhead targets, independent R&D effort and cash flow. Performance, in relationship to management budgets, is monitored on a continuing basis with planned mid-year and year-end performance reviews at the corporate level. Specific reviews are held for consideration of capital expenditure proposals and independent research and development programs to assure integrated programs with maximum benefit and minimum expenditure on a corporate-wide basis. Management budgets and operating plans are supplemented at various organizational levels with targets and controls for manpower, overhead, facility utilization and other management objectives. In addition to project and company management reviews of ongoing programs, reviews of significant and critical programs are held at the corporate level.

Mr. Milo Wietstock

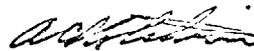
February 17, 1971

For the longer term, management planning and control is implemented through development and consideration of formal long range plans, semi-annual 10 year management forecasts and 5 year financial forecasts. These include consideration of long term capital expenditure plans and capability development programs.

During 1969 and 1970, we have stressed the importance of our financial objectives to all levels of management and in turn to all employees throughout the Lockheed organization. This matter has been given close attention at senior management meetings and in correspondence and association with operating organizations. On November 11, 1969, Mr. Houghton wrote to all members of supervision on the subject, "Managing for Profits", emphasizing our environment, our responsibilities and the need for a new spirit of involvement and achievement. Each of the Lockheed companies has followed with various special programs and efforts - to increase productivity, to improve performance, to curtail expenditures, to conserve cash - in essence, to do a better job in view of our environment.

The attached summary of considerations and actions of management is not all-inclusive. However, it should provide insight into our efforts to develop and maintain the most favorable financial environment consistent with the tasks confronting us and the resources available to us.

Sincerely,



A. Carl Kotchian  
President

Attachments

## LOCKHEED AIRCRAFT CORPORATION

EFFORTS TO CURTAIL  
EXPENDITURES AND MINIMIZE  
CASH REQUIREMENTS

The following is a brief summary of actions taken throughout the Lockheed Aircraft Corporation to curtail expenditures and minimize cash requirements. It is not all-inclusive. In particular, it does not include all those potential actions (such as disposition of assets, mergers, etc.) considered and explored by management, but determined not to be appropriate nor in the best interest of stockholders, creditors, customers or employees. This summary is presented in categories but not necessarily in order of importance.

FACILITIESCapital Expenditures

Following a series of detailed management reviews, 1970 capital expenditures were budgeted at \$100 million. This represented a net cash investment of \$38 million after deducting funds provided through depreciation. Through deferral, substitution and elimination of items, capital expenditure plans were reduced in all companies to the minimum level considered prudent for continuing operations. Actual expenditures for the year were \$63 million with net cash investment after depreciation amounting to \$7 million. Cash requirements were \$31 million less than originally planned.

Sale of Assets

In addition to the normal program of disposing of obsolete or nonproductive property, special studies were made in 1970 to consider disposition of assets not required for current and anticipated operations in the near term. Consideration was given to marketability - timeliness and value as well as potential to generate cash. As an alternative, consideration was given to requirements for security in support of borrowings. Resulting actions include the disposition of unused land at Newport Beach, California, and the sale of a 50 year land lease in Palo Alto, California. Management will continue to review the possibilities of raising cash through the sale of assets not required in operations.

### Efforts to Curtail Expenditures and Minimize Cash Requirements

#### Deactivation and Reduction of Facilities

Special reviews of marginal facilities enabled several companies to deactivate or mothball their facilities in order to reduce operating costs. The Georgia Company's Dawsonville facility was shut down and efforts are underway to dispose of land at this site. The California Company deactivated its Oxnard base for the AH-56A Flight Test activity.

Actions to reduce leased space have resulted in terminating or subleasing 218,000 square feet at the Georgia Company during 1970 with plans for an additional 172,000 in 1971. In January 1969, the Missiles and Space Company had 35 short term (five years or less) lease buildings which accounted for approximately 26% of its Bay Area building space. Today, Missiles and Space Company has 19 such buildings accounting for 16% of its Bay Area building space. This reduction of 16 buildings represents a 41% decrease in short term leased space within two years, and a reduction from January 1969 of approximately \$700,000 in annual rental costs, plus approximately \$600,000 in annual other operating costs.

#### Improved Facility/Equipment Utilization

To achieve further reductions in capital expenditures and conserve related cash, a corporate-wide effort was made to encourage the transfer of property between companies where better utilization will result. For example, the California Company acquired 220 items from other companies. In addition, eight machine tools and other equipment were rebuilt at a cost of \$443,000. Replacement cost for equivalent items was \$960,000, representing a cost avoidance of over \$500,000.

#### CONTRACT ADMINISTRATION

Cash flow was significantly improved during 1970 through efforts of the companies to negotiate timely contract modifications for faster collection of receivables. The cash pull-ahead ranged from two weeks to two years earlier than anticipated and involved over \$60 million. Important examples include: (1) timely billing of performance incentives on the Poseidon program; (2) weekly billing cycle to replace biweekly billings on certain classified contracts; (3) expedited settlement of disputed claims and final pricing of C-141 contracts at the Georgia Company, allowing collection of accrued price increases; (4) pursuit of provisional billing amendments on undefinitized contract orders where work was completed; (5) evaluation of negotiation and definitization of billing amendment 60 days sooner than normal procedure for the P-3C program; (6) incremental billings on P-3C contracts rather than one lump sum payment at completion; and (7) acceleration of Navy certifications of S-3A contract milestones.

Efforts to Curtail Expenditures  
and Minimize Cash Requirements

FINANCING THROUGH VENDORS

Efforts to shift more of the financing to suppliers during 1970 have been successful. These include: (1) negotiation of extended or deferred payment to suppliers for L-1011 equipment; (2) at the California Company, deferral of progress payments to major suppliers until collections are received under prime contracts; (3) instituting a policy not to accept and pay for materials ahead of schedule; and (4) establishing make-and-hold arrangements with vendors for a variety of materials, reducing unit cost through larger runs and deferring payment until materials are actually needed.

ACCOUNTS RECEIVABLE

Receivables at the end of 1970 were down \$45 million from year-end 1969, and were \$27 million under budget. The amount of receivables outstanding over three months declined by \$44 million during 1970. This was the result of actions taken to negotiate improved billing modifications and improved billing procedures. For example, at the Missiles and Space Company, special efforts were made to close completed contracts in 1969 and 1970 resulting in collection of approximately \$3 million each year compared to nominal amounts in preceding years. At the Electronics Company, customers mail checks directly to the Electronics Company's bank which reduces the collection cycle. In addition, precontractual expenditures were reduced from \$20 million at year-end 1969 to less than \$3 million at year-end 1970, the lowest level in several years. To summarize, the turnover of receivables improved during 1970 as the number of days of cash receipts in net receivables declined to 42 days - 12 days less than at December 1969.

INVENTORIES

Actions were taken during the year to improve inventory management. Inventory turnover increased at nearly all companies. For example, at the Georgia Company, 1970 turnover was 6.1 or 1.4 better than 1969, and at the California Company, material inventory turnover improved from 5.4 times in 1969 to 6.1 in 1970. At the Missiles and Space Company, company-owned inventories at year-end 1970 represented the lowest year-end balance since 1962. JetStar fabrication and assembly was stopped in order to keep inventories from increasing and current inventory will be substantially liquidated before production is resumed.

Efforts to Curtail Expenditures  
and Minimize Cash Requirements

PERFORMANCE TO BUDGET

Overhead Expense

As a result of reductions in personnel and several separate management goals to reduce support costs, overhead spending was approximately \$50 million less than the approved plan established at the beginning of 1970. Favorable overhead expense performance was accomplished by strict attention to each individual account and as a result, nearly every account was under budget. In addition, all companies except two were under their budgeted overhead rates by impressive margins despite lower than planned direct labor bases.

Accounts with significant underruns were primarily labor related. In March, all companies dropped their indirect/direct personnel ratios below budget and maintained this achievement throughout the year. Despite a decline in the total population of 13%, the indirect ratio declined from 1969 by 1.7 percentage points to 28.8% by year-end 1970, the lowest ratio in the Corporation's history.

New Business Expense (IR&ID/B&P)

1970 new business expenditures were the lowest since 1966. Intensive management reviews cut initial allocations by \$27 million. In addition, strict controls enforced at each company held expenditures to \$5 million below the revised budget and \$4.5 million under the 1969 level.

PERSONNEL REDUCTIONS

Total personnel decreased from 97,600 at year-end 1969 to 84,400 at year-end 1970, a total reduction of 13,200. While direct personnel declined 12%, indirect personnel were reduced by 17%. This was achieved with only minimal changes in the indirect work load and reflects the extreme measures taken to reduce overhead. The cost savings resulting from the reduced personnel level substantially contributed to the reduction of \$31 million in indirect labor, labor benefits and retirement plan costs from the 1970 budgeted level. Reduced personnel also had a far reaching effect on occupancy and other administrative costs during 1970.

Efforts to Curtail Expenditures  
and Minimize Cash Requirements

EMPLOYEE COMPENSATION

Executive Compensation

The Management Incentive Plan was eliminated for all companies for 1969 and 1970, thereby reducing remuneration to key officials of the Corporation by approximately 25% in each of these years.

Salary and Wage Rates

This area was subjected to special management attention and control in 1970, and effective results were achieved despite continued increases in cost of living and the substantial decline in the work force. For example, both the Georgia Company and the Missiles and Space Company set internal organization targets for such items as annual salary rate increases, salary rates, hourly rates and salary-hourly mix. Although 1970 hourly pay increases were established by a previously negotiated Union-Company agreement, continual scrutiny and extra controls over hourly classification mix limited the rate increase. Salary rate increases were minimized as a result of concentrated management efforts to (1) release higher paid but less effective employees, and (2) effect demotions. There were 1,372 demotions of salary personnel at the Georgia Company with reduction in rates amounting to \$1.8 million per year. There were 1,155 position audits conducted at the Missiles and Space Company resulting in over 300 downgradings with an annual salary reduction of \$233,000. In addition to all other actions, salary merit and promotional increases were held to approximately 4.0% of the corporate-wide salaried payroll compared with 6.2% in 1969 and 6.7% in 1968.

Overtime

Overtime was closely scrutinized throughout the Corporation, with many companies strengthening controls and effecting changes in salaried overtime payment policy. Salaried overtime payment was virtually eliminated at the Georgia Company except for extraordinary circumstances which resulted in the fourth quarter of 1970 showing a 75% reduction of premium costs at the Georgia Company compared to 1969.

Efforts to Curtail Expenditures  
and Minimize Cash Requirements

MANAGEMENT

Strict control over the management/organizational structure resulted in the improvement in the supervisory ratio (salaried supervisors and managers) at nearly all companies during 1970 despite a 13% reduction in total employment. This was achieved through reorganizations and consolidations at each company, which also resulted in other reduced operating costs. At the Georgia Company, 691 management positions were eliminated, a 27% reduction from 1969, leading to improvement in the supervisory ratio. Timely management actions enabled the Missiles and Space Company to maintain its supervisory ratio at a relatively stable level for the past three years despite a 35% decline in employment since 1967.

PRODUCTIVITY

Although difficult to quantify in a meaningful composite statistic, there is strong evidence that productivity throughout the Corporation improved in 1970. For example, at the Georgia Company, where total assembly and fabrication effort is by far the most significant part of their total 1970 activities, standard hours per 40-hour man improved by 33% in assembly and 5% in fabrication. At the California Company, P-3C standard hours per 40-hour man improved 5%.

The Missiles and Space Company established a 1970 objective to achieve a 15% improvement in factors affecting overall productivity and cost reduction. All managers were directed to take eight specific steps to achieve the productivity improvement program. This objective was achieved to the satisfaction of the Missiles and Space Company President.

DATA PROCESSING EXPENSE

A Task Force was established in 1970, under the direction of a Corporate Executive Vice President, to determine future computer and EDP systems activities throughout the Corporation in order to significantly reduce this expense. A study was also made of centralizing computer operations for small Lockheed companies in California. The results of these efforts are being evaluated. At the Missiles and Space Company, there was a net reduction of seven computers, resulting in annualized savings of approximately \$500,000 in equipment costs. Similar actions in 1971 will result in additional savings of more than \$900,000 annually. The Georgia Company has developed plans to eliminate equipment at an annual savings of \$632,000 in 1971.

Entirely Curtail Expenditures  
and Minimize Cash Requirements

#### COST REDUCTION PROGRAM

The Corporation greatly intensified its cost reduction program activities in 1970. Starting the year off, the highest dollar goal in the ten year history of the program was established by corporate management. As a result of this goal and corporate management direction, company management attention and promotion of the cost reduction effort were noticeably increased. At the Georgia Company, for example, a series of "cost reduction and cash conservation" meetings were held during the year by the company President and his financial staff with several hundred managers and supervisors from all functional organizations. Largely due to this pursuit by management in that one company alone, there was an increase of 60% in the actual number of cost reduction actions taken during 1970 compared to 1969, and dollar savings reported in 1970 were 52% higher than the year before.

For the Corporation as a whole, the dollar goal was met and there was a 35% increase in the number of actions implemented in 1970 compared to 1969.

#### MANAGEMENT MEMOS

Special Management Memos were issued during 1970 conveying top management's concern for controlling expenditures and minimizing cash requirements. In November 1969, D. J. Haughton issued a corporate-wide memo to all members of supervision on "Managing for Profits". A. C. Kotchian asked the company Presidents for their personal attention to cost reduction for 1970. The Missiles and Space Company President, S. W. Burriss, established for each of his organizations eight objectives to achieve increased productivity in 1970. The Electronics Company President, G. L. Seelig, wrote to all members of supervision about cost improvements for 1970. The California Company President, C. S. Wagner's report to Executive Vice President William Rieke, on the California Company cash management was also sent to the Missiles and Space Company and the Georgia Company for possible implementation.

LIST OF OFFICIALS RESPONSIBLE FOR THE  
ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT

Tenure of office  
From                      To

DEPARTMENT OF DEFENSE

SECRETARY OF DEFENSE:

Melvin R. Laird	Jan. 1969	Present
Clark M. Clifford	Mar. 1968	Jan. 1969
Robert S. McNamara	Jan. 1961	Feb. 1968

ASSISTANT SECRETARY OF DEFENSE  
(INSTALLATIONS AND LOGISTICS):

Barry J. Shillito	Jan. 1969	Present
Thomas D. Morris	Sept. 1967	Jan. 1969
Paul R. Ignatius	Dec. 1964	Aug. 1967
Thomas D. Morris	Jan. 1961	Dec. 1964

DEPARTMENT OF THE ARMY

SECRETARY OF THE ARMY:

Stanley R. Resor	July 1965	Present
Stephen Ailes	Jan. 1964	July 1965

ASSISTANT SECRETARY OF DEFENSE  
(INSTALLATIONS AND LOGISTICS):

J. Ronald Fox	June 1969	Present
Vincent P. Huggard (acting)	Mar. 1969	June 1969
Dr. Robert A. Brooks	Oct. 1965	Feb. 1969
Daniel M. Luevano	July 1964	Oct. 1965
A. Tyler Port (acting)	Mar. 1964	June 1964
Paul R. Ignatius	May 1961	Feb. 1964

Tenure of officeFrom                      ToDEPARTMENT OF THE NAVY

## SECRETARY OF THE NAVY:

John H. Chafee	Jan. 1969	Present
Paul R. Ignatius	Aug. 1967	Jan. 1969
Charles F. Baird (acting)	Aug. 1967	Aug. 1967
Robert H. B. Baldwin (acting)	July 1967	Aug. 1967
Paul H. Nitze	Nov. 1963	June 1967
Fred Korth	Jan. 1962	Nov. 1963

ASSISTANT SECRETARY OF THE NAVY  
(INSTALLATIONS AND LOGISTICS):

Frank Sanders	Feb. 1969	Present
Barry J. Shillito	Apr. 1968	Jan. 1969
Vacant	Feb. 1968	Mar. 1968
Graeme C. Bannerman	Feb. 1965	Feb. 1968
Kenneth E. BeLieu	Feb. 1961	Feb. 1965

DEPARTMENT OF THE AIR FORCE

## SECRETARY OF THE AIR FORCE:

Dr. Robert C. Seamans, Jr.	Feb. 1969	Present
Dr. Harold Brown	Oct. 1965	Jan. 1969
Eugene M. Zuckert	Jan. 1961	Sept. 1965

ASSISTANT SECRETARY OF THE AIR  
FORCE (INSTALLATIONS AND LOGIS-  
TICS):

Philip N. Whittaker	May 1969	Present
Robert H. Charles	Nov. 1963	Apr. 1969

DEFENSE CONTRACT AUDIT AGENCY

## DIRECTOR:

William B. Petty	July 1965	Present
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