

GAO

Fact Sheet for the Honorable
Pete Wilson, U.S. Senate

May 1989

ARMY PROCUREMENT

Restriction on the Purchase of Alloy Steel to U.S. and Canadian Sources



**National Security and
International Affairs Division**

B-233498

May 5, 1989

The Honorable Pete Wilson
United States Senate

Dear Senator Wilson:

This report responds to your July 26, 1988, request that we consider a procurement issue affecting one of your constituents. In its correspondence to you, the Hart International Specialty Steel Company (HISSCO), Inc., a California company, questioned the Army's decision to restrict the purchase of steel used to manufacture certain grenade bodies to U.S. and Canadian sources. HISSCO, a supplier of steel produced in West Germany, expressed concern because a large percentage of its gross revenues comes from the sale of this steel to the manufacturers of the grenade bodies.

As agreed with your office, we inquired into the Army's rationale for placing the restriction on steel sources and any actions taken on the restriction since contract award. The results of our work were discussed with your office on January 31, 1989, and are contained in this report. Our objectives, scope, and methodology are discussed in appendix I.

Summary

For assigned items, the Army's Armament, Munitions and Chemical Command (AMCCOM) is responsible for ensuring that an adequate industrial base is maintained in the United States to produce items determined to be critical to the Army's mission. In carrying out this responsibility, AMCCOM determined, after considering limited information, that the industrial base for steel needed to produce critical grenade bodies has been deteriorating and that action was necessary to guarantee that future mobilization needs would be met. To protect U.S. steel producers, AMCCOM directed prime contractors for the grenades to purchase the necessary steel from U.S. or Canadian sources for fiscal year 1988 requirements.

On May 31, 1988, AMCCOM awarded the 1988 contracts for grenade bodies. It is continuing to study the capability of the domestic steel industry and believes that the outlook for this particular sector of the steel industry is capable of handling mobilization requirements for 4140 steel. Accordingly, AMCCOM advised us that the restriction will not be necessary for future grenade procurements.

Background

The grenades in question (the M42, the M46, and the M77) are small munitions that are clustered inside artillery and multi-launch rocket system projectiles. AMCCOM has been procuring these grenade bodies, made from 4140 alloy steel and boron bearing steel,¹ since fiscal year 1975. It has awarded contracts to produce the grenade bodies to its mobilization base contractors, which have been furnished special machinery by the Army. These contractors have obtained the steel required to produce the grenade bodies from a number of domestic and foreign sources.

For fiscal years 1985 through 1987, AMCCOM authorized prime contractors, upon request, to purchase the necessary 4140 and boron steel from qualified European sources. During these years, contracts at an estimated value of \$344,653,706 were issued for a total of 373,729,191 grenades. On the basis of information provided by AMCCOM stating that the cost of the steel is between 35 and 40 percent of contract cost, we estimate that the cost of the 4140 and boron steel required by these contracts totaled between \$120.6 million and \$137.9 million.

However, in its fiscal year 1988 solicitation for grenade bodies, AMCCOM advised interested contractors that (1) 4140 and boron steel was considered critical to the U.S. mobilization base and (2) prime contractors would be required to purchase required 4140 and boron steel from U.S. or Canadian sources. This limitation was deemed necessary to protect a perceived deteriorating base for this specialty steel.

AMCCOM's Implementation of the Restriction

On August 10, 1987, AMCCOM, in furtherance of its mobilization responsibilities, issued Procurement Information Letter (PIL) 17-3-87. This PIL stated that, effective October 1, 1987, all contracts awarded for items considered critical to the national defense would be restricted to U.S. or Canadian production bases. The PIL further stated that the restriction would also apply to all appropriate levels below the prime contractor. Critical items were defined as items on the Industrial Preparedness Planning List (IPPL) and items designated to replace items on the list. The M42, the M46, and the M77 grenades were and continue to be listed on the IPPL.

AMCCOM's Industrial Readiness (IR) Directorate was assigned the responsibility of determining whether components of critical items should also be designated as "critical" and whether those components should be

¹Boron bearing steel is a substitute for 4140 steel, but it can only be used for the M42 and the M46 grenade bodies. The M77 grenade bodies require 4140 steel.

restricted to U.S. and Canadian sources. On December 21, 1987, the IR Directorate determined that the 4140 alloy and boron bearing steel used to produce the grenade bodies met the requirements set out in the PIL for designation as critical components. These requirements included the consideration of domestic production capability in both peacetime and during mobilization and the lead time necessary to develop capability, critical skills, and other special technical requirements.

AMCCOM's Decision to Restrict the Purchase of Steel to U.S. and Canadian Suppliers

After determining that the 4140 and boron steel should be classified as "critical" components, the IR Directorate, in March 1988, made an assessment of the steel industrial base. In the absence of formal guidance, the Directorate limited its survey to researching periodicals and contacting the prime contractors to determine where they obtained steel. Its assessment showed that the industrial base for steel in general was eroding and that several steel firms had filed for bankruptcy. In addition, its survey of the prime contractors for the grenade bodies showed that only three domestic steel firms were supplying the 4140 and boron steel and that two of these three firms had filed for Chapter 11 bankruptcy.

Based on the results of this survey, the IR Directorate decided that the industrial base for the 4140 alloy and boron bearing steel was limited and needed protection to ensure that sufficient production would be possible during mobilization. To accomplish this, the IR Directorate instructed AMCCOM's Procurement Directorate to require the prime contractors for the fiscal year 1988 buy of grenade bodies to purchase the necessary 4140 and boron steel from U.S. or Canadian sources. The Procurement Directorate complied with this instruction by placing notice of the restriction in the solicitations for the fiscal year 1988 grenade contracts and incorporating the restriction into the resulting contracts.

On May 23, 1988, after the fiscal year 1988 solicitations were issued, one supplier of 4140 and boron steel to the grenade contractors, your constituent, complained to AMCCOM that the restriction was not warranted. This supplier did not produce the steel but obtained it from a producer located in West Germany. With the restriction in place, this supplier would not be an approved source for the 4140 and boron steel. This supplier advised AMCCOM that (1) the entire requirement for steel to meet the Department of Defense's munitions needs represented less than one-half of 1 percent of the steel produced in the United States for any given year, (2) these buys were too small to affect the status of the U.S.

steel industry, and (3) one of the domestic suppliers identified in AMCCOM's survey had the capacity to meet the entire M42, M46, and M77 grenade mobilization requirements for 4140 steel. The supplier argued, on the basis of these figures, that the steel industrial base was in no way threatened and that the industry could easily meet the Department of Defense's needs in the event of mobilization.

On May 27, 1988, after analyzing and considering this and other new information, the IR Directorate questioned whether the source restriction needed to be placed into the fiscal year 1988 contracts. It discussed this matter with officials from AMCCOM's legal office and the Procurement Directorate. Following the legal office's advice that, notwithstanding the new information obtained by the IR Directorate, the well-being of this segment of the steel industry was still in doubt, the Procurement Directorate decided to retain the restriction and proceed with the award. The IR Directorate deferred to this decision.

On May 31, 1988, AMCCOM awarded four firm-fixed-price contracts for grenade bodies. These contracts, three 3-year contracts and one 1-year contract, have an estimated value of between \$144.6 million and \$194.5 million, depending on whether the options in the contracts are exercised. The value of the 4140 and boron steel required to produce the grenade bodies required by these contracts is estimated at between \$57.8 million and \$77.8 million.

AMCCOM's Plans for Continuing Its Use of the Restriction

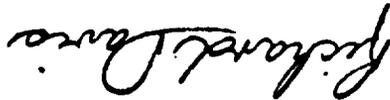
AMCCOM Headquarters' officials advised us that they will continue to study the capacity of the domestic industrial base to furnish 4140 steel for both peacetime and mobilization needs. This information will continue to be updated and, prior to the award of additional contracts for grenade bodies, AMCCOM will reconsider whether to continue imposing a source restriction on the 4140 steel. The most recent information provided by AMCCOM shows that the IR Directorate believes, on the basis of updated information, that the steel industry can now supply enough 4140 steel to meet the grenade mobilization requirement. Accordingly, the IR Directorate has recommended that future contracts for grenade bodies not include any restriction on the source of steel.

As requested, we did not obtain official agency comments on this fact sheet. However, we discussed the information we gathered with Army and Department of Defense officials and incorporated their views where appropriate.

As arranged with your office, copies will be sent to interested congressional committees, other Members of Congress, and the Secretaries of Defense and the Army. Copies will be made available to other parties upon request.

Major contributors to this fact sheet were John Henderson, Assistant Director, and Jack Kriethe, Evaluator-in-Charge. Please contact me at (202) 275-4141 if you or your staff have any questions concerning this report.

Sincerely yours,



Richard Davis
Director, Army Issues

Objectives, Scope, and Methodology

Senator Wilson asked that we examine the Army's placement of a restriction limiting steel sources in fiscal year 1988 contracts for grenade body metal parts. On the basis of subsequent discussions with the Senator's office, we agreed to provide information on

- the rationale used to justify putting the restriction into the contracts and
- any action that has taken place since the award of the contracts that might affect future procurements.

Since the scope of the request was limited to a single procurement, we focused our efforts on the U.S. Army offices responsible for the acquisition at Headquarters, Department of the Army, Washington, D.C., and Headquarters, U.S. Army Armament, Munitions and Chemical Command, Rock Island, Illinois.

We interviewed Headquarters, Department of the Army, officials responsible for approving acquisitions and officials at AMCCOM responsible for procuring the grenades, determining critical components, and managing the contracts. We also examined files pertaining to the award of contracts and to the determination of critical components.

We did not attempt to perform an independent assessment of the strength or weakness of the domestic steel industry relative to providing 4140 and boron bearing steel. Rather, we concentrated on identifying the Army's rationale for its decision.

Our audit work was performed from August 1988 through February 1989. As agreed with your office, we did not obtain official agency comments on this report. However, we discussed its contents with Office of the Secretary of Defense and Army officials and incorporated their views where appropriate. Our work was performed in accordance with generally accepted government auditing standards.

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