U.S. defense industry comes under attack

Part I of Robert Gallagher's examination of a serious threat to American defense industry's performance: the mentality of cost-accounting imposed by Robert McNamara.

This is the first in a two-part series dealing with a serious threat to the ability of U.S. defense industry to perform. In the first, we look at the spurious case of criminal fraud against the executive management of the General Dynamics Corporation. In the second, we review the implications of the Packard Commission recommendations on procurement policy. The broader point to be made in both cases is the destruction created by the mentality of cost-accounting which has been imposed upon defense policy-making since the tenure of Robert McNamara.

The case of General Dynamics

This month, Federal Judge Ferdinand Fernandez is expected to rule on a motion to dismiss the federal grand jury indictments of former NASA administrator James Beggs, the General Dynamics Corporation, and three of its managers for violation of and conspiracy to violate Armed Services Procurement Regulations during their development of prototypes for the "Sergeant York" Division Air Defense (DIVAD) gun system.

The indictments had been put together by the "Defense Procurement Fraud Unit" in the Justice Department's Criminal Division, headed by Stephen Trott, an associate of Attorney-General Edwin Meese from Alameda County, California. The indictment, issued Dec. 1, 1985, led to Beggs' resignation as NASA administrator and the temporary appointment as acting administrator of William Graham, a member of the California Republican Party.

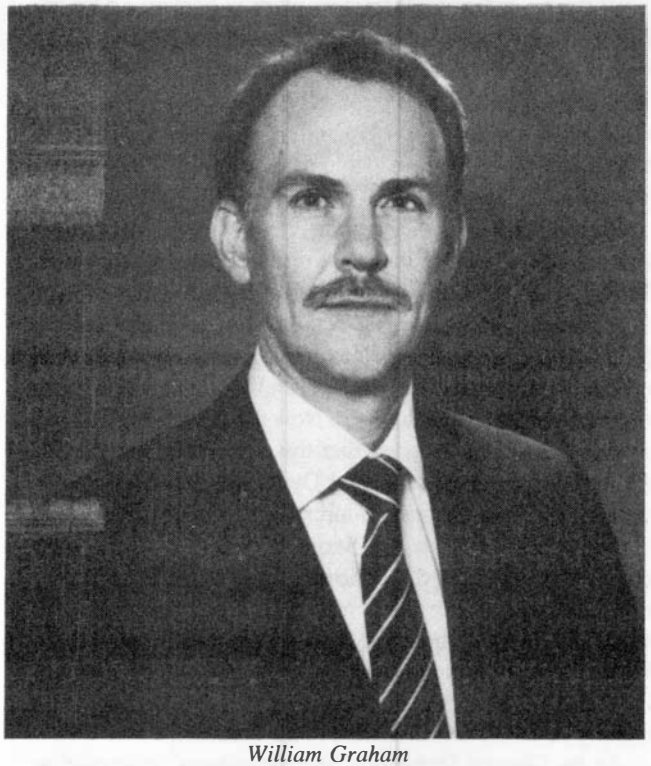
Examination of the indictment papers and of the motion to dismiss submitted by lawyers for General Dynamics, Mr. Beggs, and the other defendants show that the government has no case at all.

1) The Sergeant York gun program involved a new type of contract, known as "Firm Fixed Price, Best Effort," for which there were no governing Armed Services Procurement regulations. Beggs and the other defendants are charged with violating regulations that do not exist.

2) The indictments charge that General Dynamics overbilled the government by charging certain expenses relating to the contract to "Internal Research and Development" and "Bids And Proposals" accounting categories. However, in the items in question, the Army explicitly told General Dynamics in the development contract not to charge these items to the contract.

3) The proper jurisdiction for resolving disputes on interpretation of Armed Services Procurement Regulations, does not lie with the U.S. District Court for the Central District of California, where, for some reason, the Justice Department Criminal Division organized the grand jury. Jurisdiction lies officially with the Armed Services contracting officer, the Armed Services Board of Contract Appeals, and the federal circuit courts. The indictments charge that Beggs and the other defendants deliberately misallocated costs in order to keep down losses on the contract, involving the technical interpretation of the procurement regulations that govern accounting practices in the conduct of defense contracts and research-and-development. The Armed Services Board of Contract Appeals is the administrative body with authority to resolve such technical questions. General Dynamics has moved that the indictments be dismissed and that the case be

James Beggs



William Graham

referred to the Armed Services Board.

4) From reading the indictment, and the flow of press coverage that followed it, one would conclude that the government lost millions as a result of General Dynamics' accounting practices, and that the company protected itself against losses by dishonestly billing contract costs to the cited cost categories. In fact, nothing of the kind occurred. The government lost nothing.

Each year, the Armed Services set a limit on the amount of "internal research-and-development" and "bids-and-proposals" funds for which a contractor may be reimbursed by the Defense Department. In the years in question, according to reliable sources, General Dynamics spent more on research-and-development and bids-and-proposals work than was reimbursable—in fact, more than the amount that the Justice Department charges they misbilled to the government. The company had to swallow huge losses as a result; the issue of the billing is therefore irrelevant to the reimbursement which they would have received, since, in any case, they were owed the maximum. Therefore, even if General Dynamics did misbill certain costs, there was no injury to the government. This was, at worst, a "victimless crime."

Therefore, why?

In light of these points, the question that should come up is, why were these indictments issued? One way to answer, is to look at the effects of the indictments.

One hypothesis is that the target of the investigation was James Beggs, who, at the time, was the administrator of NASA. As we have stated before in *EIR*, there is a serious question of how the incompetent William Graham came to be placed as Mr. Beggs' deputy, despite opposition within the space agency. Was there patronage or political blackmail involved in Graham's forced appointment which was also involved in the targetting of Mr. Beggs?

Certainly, those who opposed a strong U.S. presence in space had much to gain from weakening NASA, by removing Beggs from leadership. While the problems which led to the Challenger disaster predated Beggs' withdrawal from the agency, it is more than likely that under his personal oversight, a flight under the conditions then prevailing at Cape Canaveral would have been cancelled.

While Mr. Beggs was at the helm, NASA conducted 23 successful Shuttle flights. Beggs was a strong proponent of space exploration, the development of a space station, and a manned mission to Mars, and was an outspoken opponent of the Malthusian Club of Rome. His indictment placed NASA in the hands of Graham, whose management contributed decisively to the Challenger disaster.

We must also evaluate the purpose of the indictments from the standpoint of what precedent would be set were they to result in a conviction. Let us assume for the moment that, some way, the Justice Department wins its case. Were that to occur, research-and-development work in aerospace and defense industries would grind to a halt. The Justice Department seeks to establish the precedent that any research-and-development expenditures in an area remotely related to an ongoing contract must be charged to that contract, and cannot be charged to internal research-and-development, even though it is devoted to future technological capabilities.

With any defense contractor, work is performed by the same personnel on several programs at the same time. Who decides when the work of an engineering team on antenna technology is billed to one of several projects it might be construed as applicable to? Up until now, the companies and the military services have made that decision. The DoJ indictments dispute just that.

Presently, the services grant contractors discretionary R&D funds under "internal research-and-development (IRAD)," and "bids and proposals" (B&P), to carry out advanced work. Every year, the services review a contractor's R&D. If they think they're coming up with some good results, they might raise their R&D funding. If they don't like what they see, they may lower it. Now the Justice Department has stepped in and asserted that this relationship is illegal, and that any work that General Dynamics had done on advanced, next-generation anti-aircraft guns under IRAD was "really" work done on the Sergeant York. If this charge holds, at the awarding of a contract, R&D will grind to a halt, and scientists and engineers who design program hardware might face layoffs, because Harvard lawyers like William Weld, current nominee for head of the Criminal Division, will ban their companies from work on R&D that could possibly be construed as related to the contract.

As the General Dynamics' and defendants' joint motion to dismiss states, "The policy issues involved in this case are of [great] significance. . . . At stake in this case are the B&P or IRAD regulations that will apply to the billions of dollars of contracts that the Department of Defense undertakes for national defense. . . . The decisions made in resolving the cost allocation issues in this case will set precedents with respect to the defense industry's use of bids-and-proposals and internal research-and-development funds in situations where proposals and research efforts are conducted parallel with the performance of an existing contract."

Industry sources report that the Justice Department was determined to get an indictment. The Criminal Division in 1984 sent special agent Gary Black to Los Angeles to handle the grand jury. By February or March of 1985, after one year, Black reported that there was no basis for an indictment and there were no criminal violations by either General Dynamics or the other contractor on the prototype development project, Ford Aerospace.

Black was immediately transferred back to Washington and placed in the Civil Division, and Robert Bellows from the Criminal Division was sent to Los Angeles to revive the case. Bellows never informed the companies of the revival of the grand jury. Reportedly, he orchestrated offers of immunity and threats of prosecution toward lower-level employees at General Dynamics to contrive the case against the company and its executive officers. Indeed, the indictment papers themselves make several references to unnamed "General Dynamics employees" who are cited as having done allegedly criminal acts in cooperation with the defendants, but who are not named in the indictment itself.

The DIVAD contract: study in incompetence

The Army's "Sergeant York" Division Air Defense (DIVAD) gun system was designed to fail. The contract included several features inspired by "cost-effectiveness" which guaranteed a system that would not be a significant advance over existing air defense guns. Because of this, Defense Secretary Caspar Weinberger cancelled production in 1985. The contract's ridiculous features were as follows:

1) In order to save money, it required the use of "off the shelf" components, developed for other weapon systems, so that DIVAD system integration, the development of computer software, would be the primary development task of the contractors. A May 1986 General Accounting Office (GAO) report, *Sergeant York: Concerns About the Army's Accelerated Acquisition Strategy*, states:

> The integration of the weapon's major subsystems and their application to a weapon for which they had not been originally designed apparently represented a greater technical undertaking than originally anticipated. . . .

2) The development contract was a fixed price contract. However, since development costs cannot be accurately predicted, this led to a situation where contractors were forced to compromise performance to stay within the contract's fixed price. GAO reports:

> The Army established 12 firm requirements that each competing contractor's weapon system had to meet. Beyond these, the army identified 43 system requirements in priority order which each contractor could trade off to help lower the program's cost. For example, Ford Aerospace elected not to equip its weapon with night vision capability, 1 of the 43 tradable items, in an effort to keep unit production costs down.

3) The contract included a first-ever "warranty [that] required Ford Aerospace to correct characteristics of the weapon system which did not meet the specifications at no