1947

Recapturing War Profits -- A Civil War Experience

John P. Frank
Indiana University School of Law

Follow this and additional works at: http://www.repository.law.indiana.edu/facpub
Part of the Military, War, and Peace Commons, and the United States History Commons

Recommended Citation
http://www.repository.law.indiana.edu/facpub/1872

This Article is brought to you for free and open access by the Faculty Scholarship at Digital Repository @ Maurer Law. It has been accepted for inclusion in Articles by Maurer Faculty by an authorized administrator of Digital Repository @ Maurer Law. For more information, please contact wattn@indiana.edu.
RECAPUTURING WAR PROFITS—
A CIVIL WAR EXPERIENCE

JOHN P. FRANK

World War II saw a new device in the endless history of legislative experiments to restrain war profiteering. That device was "renegotiation", in which Congress began with the premise that it was impossible to tell in advance how much it would cost to produce new quantities of new machines by new methods. The basic scheme of renegotiation, therefore, was that contractors should make their contracts as usual, but that at the end of each year the purchasing agencies of the government should analyze actual profits on actual experience, and scale the profit for each contractor down toward an amount deemed reasonable.¹

The profit control problem of World War II is a reminder that we have had the same problem in the past. The experience of World War I is reasonably familiar,² but no detailed account has been made concerning profit control, and particularly profit recapture, in the Civil War.

It is reviewed here particularly for the precedents it set for modern renegotiation.

The Civil War marked the pinnacle of war profiteering in American history. The years 1861-1865 are remembered not only for bravery in the field and suffering at home, but for "shoddy", for uniforms that fell apart in the rain, for guns that exploded in the faces of the soldiers that used them, for ships that sank as soon as they put to sea.³

During the Civil War, the governments of the North and the South were exposed to unbelievable fraud and to fantastic prices. But the Civil War experience created a machinery for profit control which may be

¹ Most of the material for this article was gathered in the course of the author's study of the Renegotiation Act in connection with work on litigation.
² Renegotiation Act of 1942, 50 App. U.S.C. Supp. § 1191. It is too soon to be certain that the new method is an unqualified improvement over its companion devices of careful contracting and high taxes. We know that hundreds of millions of dollars have been recovered by this means, but we do not yet know whether the constitutionality of the plan will be approved by the Supreme Court, and the bulk of the litigation on the Act is still in the future. Cf. Mine Safety Co. v. Forrestal, 326 U.S. 371 (1945), which might have dealt with the control problem, but which was decided on other grounds.
³ See, e.g., United States v. Bethlehem Steel Corp. 315 U.S. 289; Hensel and McClung, Profit Limitation Controls Prior to the Present War, 10 LAW AND CONTEMP. PROB. 187.
⁴ The scandals under Secretary of War Cameron, which resulted in the curative efforts described below, are set out in substantial detail in SANDBURG, ABRAHAM LINCOLN, THE WAR YEARS, ch. 18.
studied both for an appraisal of what was legally acceptable and what was successful.

**The South**

The Southern Confederacy had the same serious problem as the Northern government in dealing with contractors more anxious to make money than to serve their country in time of crisis. Since the South had no adequate method of raising funds, its problem was even more acute than the problem of the North. The short purse of the South made waste intolerable. At the same time, the South was far less industrialized than the North so that, in order to obtain industrial goods, the South had no alternative but to do business with anyone who could be induced to produce. The Northern alternatives of refusing to deal with some contractors and of importing necessary equipment from Europe, cut off from the South by blockade, were not available to the South.

The records of the Confederacy are so much less available than those of the North that it is difficult to know in any detail just how the South attempted to control profits. The historians of the South have recognized that the Confederacy never did effectively control its industrialists. For example, the Etowah Iron Works insisted on cash on delivery for sales to the Confederacy and threatened to sell to other customers if this demand was not met. Similarly, the Old Dominion Iron and Nail Works at Richmond insisted on cash in advance. Some companies refused to deliver to the Confederate War Department until all private orders had been filled and one company refused to make engine parts because it could make greater profit in making salt kettles.\(^4\)

The problems of price rises affected the civilian population as seriously as it did the Government. Soldiers received only eleven dollars a month as pay for themselves and their families. One example of the consequence of low wages and high prices is seen in the case of salt. This essential commodity had always been imported by the South. At the beginning of the War, it sold at 65 cents for 210 pounds. Six months later the price had gone up to $7.00 or $8.00 a sack at which time the governors of Georgia and Alabama seized all the salt then available and paid for it at considerably less than the market price. However, within a short time the price had continued to rise to $20.00 a sack.\(^5\)


\(^5\) Ramsdell, *supra*. 
The Government attempted several means of holding down prices. It began experiments in Government production. It entered into cost-plus contracts stipulating that no more than a profit of 75 per cent should be made by contractors, and it denied draft exemptions to the employees of contractors who were charging over the 75 per cent maximum. The states passed laws against engrossment and speculation very similar to those of Revolutionary times. However, experience revealed that the laws could not be enforced. The governors also consulted with one another concerning price fixing but seemed to have made no progress toward doing anything about it.

The central government made some attempt to keep costs down by controlling appropriations. President Davis approved of laws advancing to manufacturers 33 1/3 per cent of the cost of the construction of new plants but vetoed a bill which would have permitted larger allowances.

The principal acts of the Government were those aimed at impressment and excess profit control. Under the Confederate statutes many goods necessary for military purposes could be seized and paid for subject to review by a commission which in turn is guided by established price lists. This power was widely used and was the subject of much criticism. The Confederacy also passed what is believed to be the first excess profits tax in American history. In 1863 a statute placed a special 10 per cent income tax on profits from the sale of war materials and in 1864 a special 25 per cent tax was levied on all profits in excess of 25 per cent.

Whether or not the South ever attempted anything like renegotiation of contracts, the South, like the North, was heavily burdened in the conduct of the War by the excessive prices charged both the Government and the civilians. The South experimented with dubious success with profit control.

**THE NORTH**

In the North, the problem of war profit control was basically different from the problem in the South for one important reason: the North could

---

*Ramsdell, supra, 71, 101, 102.*

*Ramsdell, supra 21, 22.*

*Message of President Davis, January 22, 1862, 1 Richardson, Messages and Papers of the Confederacy, 158. This is the only reference in Davis' writings discovered dealing with prices and contracts. His autobiography makes no special mention of this problem.*

*For a description of the Southern impressment practices see Ramsdell, supra, 76-78.*

*Cappon, supra, 171; Ratner, American Taxation, 105.*

*Ramsdell notes that manufacturers deliberately swelled their costs in order to increase the net cash received on their 75 per cent profit contracts. "The result was that new contracts began to be forced on them stipulating fixed prices or lower profits for large quantities of their products." p. 101. The machinery of such revision is not explained.*
afford more waste. The Northern treasury was low at the beginning of the War and the cost of war production was a tremendous drain on Northern resources, but it was a cost which could be met by greenback inflation, taxes, and bond sales. In the South, on the other hand, no methods could produce enough money. The consequence was that the South used price control methods very similar to those of the Colonies in the Revolution, which were also based on an almost fatal shortage of money. The South, for example, thus utilized impressment to an extent not attempted in the North.

In the North, the worst profit and fraud scandals occurred in the first year of the War. Whether the first Secretary of War, Simon Cameron, was personally honest remains a debated question; but there is no doubt that he lacked either the capacity or the desire to administer War Department purchasing on a careful basis. The scandals did not disappear with the appointment of his successor, Edward M. Stanton, but they diminished so markedly that public attention turned to other problems. The chief reason for the early scandals was that orders were placed promiscuously, without centralized direction, by countless military and state officials; and that the orders were placed without any comparative price estimates based either on public bidding or private investigation. The War Department Commission on Ordnance and Ordnance Stores reported in 1862 that many of the contracts which it had reviewed were "strongly marked with improvidence." The Commission found that excessively large orders had been placed and that their prices were "beyond necessity or reason." This condition they traced to a failure to comply with the common precaution of business.

For whatever reason, there were scandals. General Fremont’s mismanagement of his department was particularly notorious. For example, on one contract for the construction of five forts for $191,000, $111,000 was profit. Pistols and horses were sold to the Government for at least twice their fair value and much of the stock and equipment thus purchased proved worthless.

No one could seriously defend some of the scandals discovered, but

---

12 For a study of the cost of the War to the North as compared with the South, see James L. Seller, _An Interpretation of Civil War Finance_, 30 Amer. Hist. Rev. 282.
15 Randall, _Civil War and Reconstruction_, 423; and see 633. For an elaborate summary of the early Civil War purchasing scandals and some of the methods used to control them, see Meneely, _The War Department_, 1861, vol. 300 of Columbia University Studies, and see Fite, _Social and Industrial Conditions During the Civil War_, 84.
there was some excuse for them in the sheer necessity of the situation. As at the beginning of any war, it was, in the eyes of many, a practical impossibility to purchase with care because of the inexperience of the purchasing agents and because of the necessity for speed. President Lincoln conceded that purchasing had been conducted in extraordinary fashion, but said:

I believe that by these and other similar measures taken in the crisis, some of which were without authority in law, the government was saved from overthrow.\(^6\)

And the War Department, too, defended itself on the grounds of inexperience coupled with the necessity for speed.\(^7\)

The first steps toward improvement came as a result of aroused public opinion. In the winter of 1861 the House of Representatives created a special committee on war contracts which conducted lengthy hearings throughout the country. These hearings, totaling approximately 2700 pages of testimony and reports, were laid before Congress and the administration with a challenge to do something about it.\(^8\) In laying the report before the House the Committee chairman, Rep. C. H. Van Wyck from New York described some of the scandals discovered: $32,000 profit on a cattle contract to the middlemen who performed no services whatsoever; purchase of $21,000 worth of straw hats and linen pantaloons, the hats being too small for any use and the pants worthless; purchase of a ship, the Cataline, for $50,000 from a person who had been tipped off a day previous by the purchasing officer and who thereupon bought the ship from its original owner for $18,000; purchase of a thousand horses, most of them useless, including horses with running sores and horses over 20 years old; bribery of Government officials; purchase of ships at far over double value, many of which were so poorly constructed that they sank at sea.\(^9\)

One transaction described by Rep. Van Wyck attracted attention to such an extent that it was probably substantially responsible for the action which followed. In that case a Mr. Eastman discovered that the War Department had about 5,000 Hall’s carbines on its hands which had been condemned for military use and which it was willing to sell for $3.50 apiece. Eastman arranged to purchase the guns, but

\(^9\) Cong. Globe, 37th Cong., 2d Sess., 710 et p; and for other discussion see 717, 1380, 1743 (Fremont scandals), 1863.
did not actually do so until after he had arranged their sale to a Mr. Stevens, in turn financed by Mr. J. P. Morgan, at $13.50 apiece. Stevens, who had some arrangement not wholly clear with General Fremont to assist in procurement, offered the guns for sale to Fremont (i.e. to the War Department) at $22.00 apiece. Fremont accepted. Eastman then closed his own deal with the War Department after unimportant alterations, leaving approximately $50,000 in the pockets of Mr. Eastman and another $50,000 in the pockets of Stevens and Morgan for the service of selling to the War Department guns already owned by the War Department and once condemned by the Department as obsolete. 

In the light of such incidents as these, Rep. Van Wyck said:

The mania for stealing seems to have run through all the relations of government—almost from the general to the drummer-boy; from those nearest the throne of power to the merest tide-waiter. Nearly every man who deals with the Government seems to feel or desire that it would not long survive, and each had a common right to plunder it while it lived.

The War Department, under pressure, adopted several measures to prevent frauds and control profits. Among them were government production of goods in competition with private industry to provide a yardstick and pull down prices; requisition of all foreign arms imported into the country; and the appointment of a Commission on Ordnance. Coupled with these steps was improved administration, taking of bids on contracts, and, later in the war, a decision by the Supreme Court holding that a contract to procure government orders was void as against public policy.

Oddly enough no particular reliance seems to have been placed on taxation, and while the North adopted the country's first income tax and later included in very moderate degree the notion of progressive rates, the acts were not thought of as profit control measures.

In addition Congress and the War Department made an effort to prevent the fulfillment of some of the worst of the contracts and to recapture some of the excessive profits paid.

The Congressional Committee on Government Contracts apparently recovered some money through a form of voluntary renegotiation. One middleman investigated by the Committee repaid about $6,000 which was

---

20 For full details of this transaction see case No. 97, Commission on Ordnance, supra, p. 485.
21 CONG. GLOBE, supra, 711.
22 Report of Sec. of War, 1861, supra, p. 8; Report of Sec. of War, Dec. 1, 1862, 38th Cong., 3rd Sess., SEN. EXEC. DOC. No. 1.
23 Report of Sec. of War, 1861, 7.
transferred by the Committee to the Treasury. The Committee alleged that it saved $1,300 in connection with another contract and substantially more as a result of its consideration of still others. Yet the extent to which the Committee itself actually recaptured profits seems small. At the instance of the Committee, the House of Representatives even attempted to cut some of the excessive profits by direct legislative action on particular contracts. In the matter of the Eastman carbines purchased from the War Department at $3.50 and sold back to the War Department for $22.00, Congress requested the Secretary of the Treasury "to adjust" the claim at $12.50 a carbine. The House also condemned the practice of making government purchases without open and fair competition.

However most of the actual work of reconsidering and repricing particular contracts fell on the special Commission on Ordnance and Ordnance Stores which the War Department established at the Committee's recommendation. This Commission, consisting of Joseph Holt and Robert Dale Owen, was directed "to audit and adjust all contracts, orders, and claims on the War Department in respect to ordnance, arms, and ammunition, their decision to be final and conclusive as respects this department on all questions touching the validity, execution, and sums due or to become due upon such contract, and upon all other questions arising between contractors and the government upon such contracts." The members of the Commission were so eminent that their proceedings received great respect. Holt had been Postmaster General and Secretary of War in Buchanan's Cabinet, and upon completion of his work on the contract commission became the first Judge Advocate General of the Army. Owen was a former member of Congress, had practical experience in war procurement, and was one of the country's foremost social theorists and a leading advocate of emancipation.

By July, 1862, the Commission had disposed of over 100 cases, involving more than $50,000,000. It had refused payment of about $17,000,000 by

---

27 Whether there was any appreciable voluntary readjustment of contracts with the Government during the Civil War except through the Commission on Ordnance is not known. RANDALL, supra, p. 633, makes reference to one contractor who turned $25,000 back to the government.
28 Resolution of April 30, 1862. Cong. Globe, supra, 1866-88. The House also passed a resolution censuring Mr. Cameron, who had already resigned as Secretary of War, for his general contract policies. The House had before it, although it does not appear ever to have acted upon, a further resolution reported by the Committee which ordered the Secretary of the Treasury to make no further payments in connection with the ship Cataline referred to above in the text.
29 Letter of Secretary of War Stanton, Mar. 13, 1862, contained in the Commission's report.
the rejection of certain claims, by modification of others, "and by the reduction of prices when found excessive or extravagant." 30

The Commission interpreted its letter of authorization to be a charter which permitted it to revise the relations of the contractors and the government whenever necessary in the interests of substantial justice. In the normal case, it was unnecessary for the Commission to alter the contracts in the technical sense of retroactively changing their provisions. An easier method was at hand. Most of the contracts had some technical deficiency on the basis of which the Commission could hold that no contract, in the legal sense, existed at all; and, therefore, the Commission could enter into a new arrangement with the contractor.

The leading case exemplifying this technique is No. 72, the case of William Mason. 31 In this case the contractor had a contract to furnish 50,000 Springfield rifles at certain dates, and also had the right, under certain conditions, to double the number to be supplied by him. The Commission found that the government, in all its contracts for Springfields, had arranged to purchase about three times as many as were needed and

---

30 The Commission reported: "The amount, from the payment of which the government, by the action of this commission, will be relieved, will fall but little short of seventeen millions of dollars. This result has been reached by the rejection of some claims and contracts, by the curtailment or modification of others, and by the reduction of prices found excessive or extravagant. We are well satisfied that no principle of law has been violated in the conclusions at which we have arrived; that considerations of equity, when these existed, have not been overlooked; and that no undue advantage has been taken of the power of the government in dealing with its citizens. In our desire to protect, as far as practicable, the public interests, no private right has been infringed, nor is it believed that any one of the contractors whose engagements have been the subject of our investigations will, if provident and reasonably skilful in the execution of his contract, suffer loss, or fail to realize a fair profit . . . "It has been the endeavor of the commission not only to be just, but, as far as possible, to satisfy the claimants that we had been so. Accordingly, by repeated conferences with frank explanations offered to the parties, both as to the strict legality of the action proposed and as to its absolute necessity from considerations of public policy, we have sought to secure their acquiescence in our decisions. Our efforts in this direction have met with an unlooked for success. It may be safely affirmed that a large majority of the claimants are content with the disposition made of their cases. Many of them, public spirited citizens, have cheerfully expressed their assent; some verbally, others in writing. That amid the variety of character presented by so large a number of shrewd business men, exceptions to this should have presented themselves, will surprise no one who reflects that in every society will be found those who—setting up a distinction between honesty in public and honesty in private affairs—find it difficult to realize that the government has any rights, or the law, which protects its treasury, any obligatory force as against their own personal interests. Such men seem to delude themselves with the belief that however much they may be bound to respect the property of its individual citizens, the country, as a whole, is a fair subject of plunder—a belief of ready growth amid the disorders consequent upon great national convulsions. A few such men we have encountered, and while our action has necessarily left upon them an unpleasant impression, it is altogether probable that their baffled schemes against the public treasury will hereafter become the basis of appeals to Congress."

31 All the cases referred to are set forth in the report of the Commission, supra, and will be described by the number given them in the report hereafter.
stated as one of its objectives "to bring down the total number of Springfield muskets, which the government shall be bound to accept, to some six hundred thousand . . . " It reported that with this object in view it had already scaled down thirty-two such contracts.

The Commission then set forth the legal grounds on which it claimed the right to make such reductions. It found that the "right clearly exists, if the contract or order is not obligatory on the government, because essentially defective in its terms or conditions, or in any important notice required to precede it, or in any omission therein of provisions strictly prescribed by law for the protection of public interests and the prevention of fraud." It thereupon found the Mason order and "all other similar orders issued by the War Department in the autumn and winter of 1861-62, thus essentially defective." This conclusion was based on the failure of the order to be preceded by advertisement for bids in accordance with the applicable statute and regulations, and on the failure of the contracts to contain the requisite clause that no member of Congress should be admitted to any benefit under the contract. The Commission held, in consequence, that there was no binding contract. It ordered that 30,000 rifles be purchased from Mason if he would sign a bond making himself liable for damages upon a failure to deliver that number.\(^2\)

Armed with this theory, the Commission proceeded to rewrite contracts generally. Where a contractor failed to deliver rifles on time, the price was cut on those he did deliver and the rest of his order was cancelled;\(^3\) when another contractor failed to deliver on time under a contract for 50,000 rifles, his price was cut for those behind in delivery;\(^4\) in the case in which Senator Simmons of Rhode Island had accepted $10,000 to assist a constituent in obtaining an order, the contract was cut in half;\(^5\) and in the case of the sale of condemned government rifles to Fremont, described above, which arose on the claim of Mr. J. Pierpont Morgan for payment, the price was scaled down to approximately half of the amount contracted for.

\(^2\) The legal theory of the Commission concerning the invalidity of the contract by reason of the failure to place the order after bids had been received indicates that the Commission was straining after any possible technicality to reach its result. The relevant provision of the statute, § 5 of the Act of Mar. 3, 1809, provided that supplies should be bought "by open purchase, or by previously advertising for proposals respecting the same." (Emphasis added) The applicable War Department regulation under the statute provided that purchases should be made after advertisement except "when the public exigencies do not require immediate delivery of the article." The holding of the Commission is, therefore, a holding that the purchasing officers of the department were wrong in their conclusion that in the first months of the Civil War "public exigencies" required "immediate delivery" of munitions.

\(^3\) Case No. 26.

\(^4\) Case No. 36.

\(^5\) Case No. 100.
In many cases the Commission approved existing contracts without deduction. Typical is the brief opinion in a case\textsuperscript{36} dealing with a contract for 6,000 shells; “The Commission find that the parties are prepared to go on with the order; that the shells are needed by the government, and the price reasonable; and therefore direct that they be received under the terms and to the extent of the original order . . .” In other cases, modifications were made by agreement. For example, a contractor was to deliver 10,000 rifles at $27.00 each. The Commission found the order invalid and the price exorbitant, and made a new arrangement to purchase the guns at $11.00 each.\textsuperscript{37} In another case, a contractor was to deliver 150,000 guns, many of which had been accepted. The Commission, dissatisfied with the quality of the product, made an agreement to pay at actual cost plus two and one half per cent profit to the contractor.\textsuperscript{38}

Many of the revisions were prospective in effect. Examples, in addition to those cited above, are case No. 17, cutting the number of swords to be delivered by the contractor, and case No. 45 in which Secretary Cameron had personally arranged an order to purchase 40,000 Austrian muskets at $20.00 apiece. The Commission cut the number to be procured to 20,000 at $16.00 apiece, saying, “This order being for guns not desirable for the service, at an unreasonable price, and given in a manner not in accordance with law and regulations, the commission felt it incumbent upon them to reduce the numbers as well as the price of these arms . . .”

However, some of the alterations were retroactive. For example, in one case\textsuperscript{39} sabers were to be delivered subject to inspection. The sabers were delivered, accepted, and partially paid for. The Commission found them inferior in quality and thereupon ordered that in settling the account the Treasury pay for the remaining sabers at a lower price and that the Treasury withhold enough from those subsequent payments to bring down the price paid on the sabers already delivered and paid for to the proper, lower price. A similar decision was reached in another case,\textsuperscript{40} in which the government had purchased, accepted, and used the contractor’s rifles. These rifles were found, in use, to be of an inferior quality, and it was therefore ordered that the amount remaining to be paid be adjusted downward to reduce the price on those accepted, used, and paid for as well as on those as yet unpaid for. In this case the Commission found that no valid contract existed, following the theory of Mason’s case, \textit{supra}; but it was apparent, in view of the Government’s acceptance and use of the rifles,

\textsuperscript{36} Case No. 33.
\textsuperscript{37} Case No. 6.
\textsuperscript{38} Case No. 15.
\textsuperscript{39} Case No. 40.
\textsuperscript{40} Case No. 95.
that this case is in truth a clear example of the retroactive alteration of the terms of an existing agreement. So also is another case,\textsuperscript{41} in which the government retroactively reduced the amount contracted to be paid for cannon to exclude payment of the manufacturer's patent royalty.

These cases demonstrate that in the early years of the Civil War the War Department had a rough machinery for what amounts to renegotiation of contracts, and that it consistently reduced prices where excessive profits would have otherwise been made. Procedurally, also, the Commission used devices similar to contemporary renegotiation. Cases were submitted to the Commission on the basis of department files and correspondence. Claimants filed briefs in the form of letters and appeared personally on occasion. When they did appear, they were questioned by the Commission. The Commission eventually made its determination in the light of the facts of the particular case and also in the light of their general knowledge of the needs of the department and of general cost conditions throughout the entire industry. The Commission concluded with a written determination, which, under their original authorization, was intended to be absolutely binding and final. In no instance did any court review the actions of the Commission.

The Civil War had more than its share of price scandals and the various devices of government competitive production, gradually improved administration, Congressional investigations, and reconsideration of contracts by the Commission, were not sufficient means of control. But the efforts of the government, fumbling and experimental as they were, at least show some aspirations toward the principle that no one should make excessive profits out of war.

\textsuperscript{41} Case No. 103.