Reprinted from The Government Contractor, with permission of Thomson Reuters. Copyright © 2019. Further use without the permission of West is prohibited. For further information about this publication, please visit *http://legal.thomsonreuters.com*, or call 800.328.9352.

The Government Contractor®

Information and Analysis on Legal Aspects of Procurement

Vol. 61, No. 40 **October 30, 2019**

Decisions

¶ 320

Salaries For Lobbying Are Expressly Unallowable, Fed. Cir. Holds

Raytheon Co. v. Sec'y of Def., 2019 WL 5280873 (Fed. Cir. Oct. 18, 2019)

Salary costs for lobbying activities are expressly unallowable under Federal Acquisition Regulation 31.205-22, the U.S. Court of Appeals for the Federal Circuit has held in affirming the Armed Services Board of Contract Appeals.

In June 2005, Raytheon Co. submitted its 2004 incurred cost rate proposal for a cost-plus-fixed-fee contract. The Defense Contract Audit Agency reviewed the cost proposal in April 2006 and found that it contained expressly unallowable costs. In May 2011, an administrative contracting officer issued a final decision determining that Raytheon's proposal included over $220,000 of expressly unallowable lobbying salary costs.

The CO demanded that Raytheon repay the Government for these reimbursed expressly unallowable costs, and assessed penalties and interest against Raytheon under FAR 42.709-1(a)(1). The ASBCA upheld the CO's decision, finding that the lobbying costs were subject to penalty because "[c]osts associated with certain named lobbying activities are stated to be unallowable under FAR 31.205-22" and "they are [thus] expressly unallowable." *Raytheon Co.*, ASBCA 57743, 17-1 BCA ¶ 36,724. Raytheon appealed.

Under 10 USCA § 2324(e)(B), certain costs are unallowable, including "[c]osts incurred to influence (directly or indirectly) legislative action on any matter pending before Congress, a State legislature, or a legislative body of a political subdivision of a State." Section 2324(a) requires that armed forces contracts include provisions mandating disallowance of costs that are unallowable under a cost principle in the FAR or agency FAR supplement.

Section 2324(b) further provides that if "a cost submitted by a contractor in its proposal for settlement is expressly unallowable under a cost principle referred to in subsection (a) that defines the allowability of specific selected costs, the head of the agency shall assess a penalty against the contractor."

The FAR has corresponding provisions. FAR 31.205-22(a) states that "[c]osts associated with the following activities are unallowable: ... (3) Any attempt to influence the introduction of Federal, state, or local legislation ... through communication with any member or employee of the Congress or state legislature."

FAR 42.709-1(a)(1) provides for penalties on contractors if "the indirect cost [submitted by a contractor] is expressly unallowable under a cost principle in the FAR, or an executive agency supplement to the FAR, that defines the allowability of specific selected costs." See also FAR 42.709-0(a)(1).

FAR 31.001 defines an "[e]xpressly unallowable cost" as "a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable."

At the Federal Circuit, Raytheon argued that salaries of employees who participate in lobbying activities are not "expressly unallowable under a cost principle in the FAR." Raytheon contended that an item of cost must be mentioned or identified by name to be expressly unallowable, and that the generic language of "costs associated with [lobbying activities]" in FAR 31.205-22 was insufficient.

The Federal Circuit rejected this interpretation. The FAR 31.001 definition of "expressly unallowable cost" refers to "a particular item or type of cost." These two categories of costs confirm that an "expressly unallowable" cost includes more than an explicitly stated item. Costs unambiguously falling

 © 2019 Thomson Reuters

within a generic description of a type of unallowable cost are also expressly unallowable, the Federal Circuit said.

Salaries of in-house lobbyists are a prototypical lobbying expense. FAR 31.205-22 disallows "costs associated with" activities such as "attempt[ing] to influence ... legislation ... through communication with any member or employee of the ... legislature" or "attend[ing] ... legislative sessions or committee hearings." FAR 31.205-22(a)(3), (5). Salaries of corporate personnel involved in lobbying are unambiguously "costs associated with" lobbying. The prohibition of lobbying expenses, under the plain language of FAR 31.205-22, bars charging salaries of in-house lobbyists to the Government, the Federal Circuit said.

The Federal Circuit also rejected Raytheon's argument that the 1984 amendment to FAR 31.205-22 created uncertainty on the allowability of salaries as lobbying expenses. In 1982, the Defense Acquisition Regulation (DAR) published a rule making unallowable the "costs of lobbying as defined herein, including the applicable portion of the salaries of the contractor's employees ... engaged in lobbying." DAR 15-205.51(b). Similarly, the civilian Federal Procurement Regulations (FPR) made unallowable the "costs of lobbying, including the applicable portion of the salaries and fees of those individuals engaged in lobbying efforts on behalf of a contractor."

In September 1983, the FPR and DAR were replaced by the FAR, as the "single regulation for use by all Executive agencies in their acquisition of supplies and services." 48 Fed. Reg. 42102 (Sept. 19, 1983). FAR 31.205-22 mostly retained the original DAR language providing that "[t]he costs of lobbying, including the applicable portion of the salaries and fees of those individuals engaged in lobbying efforts ... are unallowable." 48 Fed. Reg. at 42320. FAR 31.205-22 was amended in 1984 to include its current language of "[c]osts *associated with* the following [lobbying] activities are not allowable." 49 Fed. Reg. 18260, 18278 (April 27, 1984) (Court's emphasis).

Although the 1984 amendment removed the explicit language about "salaries" and added the broader phrase "costs associated with," this created no ambiguity about whether salary is included in this more general language, the Federal Circuit said. The amendment's primary focus was to more specifically define which types of activities constituted lobbying. The regulatory history showed no uncertainty about including salaries in the prohibition on lobbying costs. Id. at 18260.

The phrase "costs associated with" was meant to include the costs of lobbying and "activities undertaken to facilitate that lobbying." Id. at 18261. For example, the notice adopting the rule stated that "if a lobbyist spends four hours lobbying the Congress and an additional eight hours in study, consultation, and preparation for the lob[b]ying, the full twelve hours ... are disallowed." Id. at 18272.

The only concern about salary costs in the revision was whether the entire salary of in-house lobbyists was unallowable, or only the part attributable to lobbying. Id. at 18261. In choosing the allocation approach requiring contractors to separately document unallowable costs, the 1984 version of FAR 31.205-22 adopted a recordkeeping provision related to "[t]ime logs ... or similar records documenting ... an employee's time ... [when] the employee engages in lobbying." Id. at 18279. That provision has meaning only if salaries for time spent lobbying were disallowed. Nothing in the regulatory history suggests that salaries were excluded from this prohibition. "[W]e do not presume that the revision worked a change in the underlying substantive law" where, as here, "there is no such clear expression [of an intent to make a change] in the shift from the specific language to the general," the Federal Circuit said, quoting *Keene Corp. v. U.S.*, 508 U.S. 200 (1993); 35 GC ¶ 351.

Raytheon also argued that the specific reference to compensation costs of employees in FAR 31.205-47 indicates that the lack of such a reference in FAR 31.205-22 showed an intent to exclude compensation from its scope. The Federal Circuit rejected this argument.

FAR 31.205-47 makes unallowable "[c]osts incurred [by a contractor] in connection with [certain] proceeding[s] brought by ... [the] Federal ... government," including "costs of employees, officers, and directors." FAR 31.205-47. This FAR subsection derives its language from the statute it implements—10 USCA § 2423(k)—which defines costs as including "the pay of directors, officers, and employees of the contractor ... for time devoted ... to such proceeding." § 2324(k)(6)(B)(ii)(IV). "The decision to mimic the statutory language in this FAR provision hardly suggests that [FAR 31.205-22] (which was not based on similar statutory language) should be interpreted to exclude salaries or to convey ambiguity," the Federal Circuit said.

© 2019 Thomson Reuters

Finally, Raytheon relied on a prior ASBCA decision holding that "[n]either [bonus and incentive compensation] 'BAIC' cost nor 'compensation' cost is specifically named and stated as unallowable under th[e] cost principle [in FAR 31.205-22], nor are such costs identified as unallowable in any direct or unmistakable terms." *Raytheon Co.*, ASBCA 57576 et al., 15-1 BCA ¶ 36,043. That decision does not bind the Federal Circuit, and "is contrary to the plain language of [FAR 31.205-22] to the extent that it concludes that salaries in the form of bonus and incentive compensation for lobbying and political activities are not 'expressly unallowable,' " the Federal Circuit said.

The Federal Circuit held that salary costs for lobbying activities are expressly unallowable under FAR 31.205-22 and affirmed the ASBCA.

✦ **Practitioner's Comment**—Although the Federal Circuit's decision is limited to the treatment of salary under FAR 31.205-22, the Court's analysis is troubling nonetheless. First, the decision suffers from an inherent misunderstanding between the concepts of an unallowable cost and an expressly unallowable cost. Whereas a cost may be unallowable, it is not necessarily expressly unallowable, which is subject to penalty. Congress established expressly unallowable costs and the resultant penalty to apply in very limited circumstances. Indeed, the original standard for the penalty was a cost that was unallowable by "clear and convincing evidence"; however, recognizing that such standard did not limit the penalty, Congress changed the definition to "expressly unallowable" with its "specifically named and stated" standard. The onus is on the Government to precisely name and state the item or type of cost that is unallowable if it is to be subject to penalty. Thus, although the Court's analysis might be consistent for determining allowability, it fails on the expressly unallowable distinction. The threat for contractors is whether this new "unambiguously" unallowable standard will open a door to broader application of penalties.

Second, and similarly, is the implication of the "associated with" language upon which the Court relied. The term "associated with" is imprecise, and should not be a basis upon which to apply the penalty. Moreover, other cost principles contain similarly vague language, such as "in connection with." Invariably, the DCAA will be emboldened to allege that a wide range of costs are expressly unallowable under the amorphous language. The Court's decision likely has opened the door to endless disputes of what is "unambiguously" unallowable. Congress sought to solve that problem with the "specifically named and stated" standard.

Third, the Court's decision will likely affect and complicate compliance with Cost Accounting Standard 405, which uses the exact same definition of expressly unallowable cost regarding the obligations under that standard.

Looking at the case from another perspective, it seems that the Court was motivated by its inability to reconcile what other type of cost than the salary of in-house personnel engaged in lobbying activities FAR 31.205-22 could govern. And, the Court looked at the administrative history; the pre-FAR version of the cost principle specifically called out salary. It is my understanding that Raytheon did not argue that the removal of specific identification of salary made the allowability uncertain; but, rather that the removal of a specific statement of salary from the cost principle took it out of the purview of an expressly unallowable cost. And, the Court did not endorse the analysis underlying the ASBCA's decision that "directly associated" costs are expressly unallowable. This decision should be limited to the salary of employees engaged in lobbying activities.

This Practitioner's Comment was written for THE GOVERNMENT CONTRACTOR by* Paul E. Pompeo, *a Partner at the law firm of Arnold & Porter in its Government Contracts and National Security Practice. Mr. Pompeo is specially rated in Chambers USA for his work in Cost Disputes, and is a former Co-Chair of the American Bar Association Accounting, Cost & Pricing Committee. As a disclaimer, Mr. Pompeo represented Raytheon in Raytheon Co., ASBCA 57576 et al., 15-1 BCA ¶ 36,043, discussed in the case description.

© 2019 Thomson Reuters