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Government Entitled To CAS-Clause Equitable Adjustment Triggered By Accounting Change, COFC Holds

Viacom, Inc. v. U.S., 2006 WL 1388415 (Fed. Cl.
May 8, 2006)

Applying revised Cost Accounting Standard 413 governing segment-closing accounting to pension costs attributable to contracts entered into under the original version of CAS 413 is a Government-mandated accounting change requiring an equitable adjustment. The Government is, therefore, entitled to an equitable adjustment for pension-deficit liability that is greater under revised CAS 413 than it would have been under original CAS 413, the U.S. Court of Federal Claims has held. The COFC also held that a contractor's recovery under the original CAS 413 does not include the portion of a pension deficit attributable to subcontracts.

In addition, following its previous interpretations of CAS 413 in *General Motors Corp. v. U.S.*, 66 Fed. Cl. 153 (2005); 47 GC ¶ 340; and *Teledyne Inc. v. U.S.*, 50 Fed. Cl. 155 (2001), aff'd, 316 F.3d 1366 (Fed. Cir. 2003); 45 GC ¶ 69, the COFC held that a segment-closing adjustment was not barred by (1) failure to fund claimed pension costs, (2) failure to give Limitation of Funds (LOF) or Limitation of Costs (LOC) clause notices, or (3) a general release. The COFC also adhered to rulings that bar profit on a segment-closing adjustment and claims for portions of pension deficits attributable to contracts that predate the original version of CAS 413 or to firm-fixed-price contracts that are governed by original CAS 413.

The case arose from the Government contracts of two business units of a Viacom predecessor company. Both units, Machinery Technology Divi-

sion (MTD) and Electronic Systems Group (ESG), qualified as separate segments, and their closures triggered CAS 413 segment-closing provisions. Under the original and revised versions of CAS 413, as part of the pension-cost adjustment that occurs when a segment closes, the Government may be liable for its share of a pension deficit and may recoup its share of a pension surplus.

MTD Segment Closing—Viacom's MTD unit signed cost-plus-fixed-fee contracts with the Navy in 1983 and 1986. Both contracts incorporated the original CAS 413 segment-closing provision: "If a segment is closed, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated The difference between the market value of the assets and the actuarial liability for the segment represents an adjustment of previously-determined pension costs."

After failing to receive a follow-on contract, the MTD segment closed. The parties agreed that, because MTD did not enter into a contract after the March 30, 1995 effective date of revised CAS 413, original CAS 413 governed the segment closing. MTD claimed entitlement to pension-deficit costs under the segment-closing provisions.

Following its *General Motors* decision, the COFC ruled that Viacom's failure to fund the claimed pension costs did not bar the claim. *General Motors* held that the general requirement—under the Federal Acquisition Regulation cost principle (FAR 31.205-6(j)(2)(i)), the Allowable Cost and Payment Clause (FAR 52.216-7(b)(2)), and CAS 412—for a contractor to fund pension plans before seeking reimbursement is distinct from the CAS 413 segment-closing adjustment. "The government has not presented any argument that would lead the court to question its prior ruling in *General Motors*," the COFC said. Although funding the pension deficit is not a prerequisite to CAS 413 recovery, Viacom must apply the funds it receives to the pension plan "to cover the portion of the deficit which Viacom has not paid."

The COFC also adhered to the *General Motors* ruling on the effect of the LOC and LOF clauses, which require the contractor to notify the Government when the contractor approaches cost or funding limits. Viacom's failure to give these notices did not bar a claim because these clauses protect the Government from Anti-Deficiency Act violations and cost overruns on specific contracts. As the COFC explained in *General Motors*, the CAS 413 adjustment does not involve any individual contract, and the LOF and LOC clauses, therefore, do not apply. "[T]he government may not hide behind the Anti-Deficiency Act when there is a binding obligation to pay and the government has general appropriations sufficient to cover the contractual obligation," the COFC said.

Moreover, under recognized exceptions, the clauses do not apply to Viacom's CAS 413 adjustment because (1) during performance, Viacom's predecessor could not have reasonably foreseen the MTD segment closure and the need to pay for a pension deficit, (2) the predecessor could not avoid the CAS 413 segment-closing costs by stopping work and (3) the Government's decision to include CAS 413 in its contract makes it "inequitable for the Government to refuse to fund Viacom's CAS 413 claims simply because it turned out upon a segment closing that the 413 adjustment results in a deficit."

The COFC, again following *General Motors*, held that (1) a general release did not bar Viacom's claims because the "'status' of those contracts—whether they are open or closed—is not relevant given the CAS 413 requirement for a 'current period' adjustment" and (2) Viacom is not entitled to profit on the segment-closing adjustment because it is not an equitable adjustment of an individual contract.

Following its *Teledyne* decision, which the Federal Circuit affirmed, the COFC further held that a contractor cannot recover portions of a pension deficit attributable to contracts that predate original CAS 413 or to firm-fixed-price contracts governed by original CAS 413.

Addressing the only previously unresolved issue concerning the MTD segment closing, the COFC held that, for contracts covered by the original CAS 413, Viacom could not recover the part of a pension deficit attributable to subcontracts. In contrast to revised CAS 413, the original standard does not mention subcontracts, and the COFC declined to read them into the coverage.

ESG Segment Closing—The ESG unit performed firm-fixed-price, fixed-price-incentive and cost-

type contracts for the Government. Some contracts were entered into before original CAS 413, some after original 413 but before revised CAS 413, and some after revised CAS 413. Revised CAS 413 was promulgated, in part, to include a formula for allocating the segment-closing adjustment between the Government and contractors and to extend the adjustment to firm-fixed-price contracts and subcontracts.

The 1996 sale of ESG constituted a segment closing under CAS 413, and Viacom's predecessor made a claim for pension-deficit costs. Though the ESG segment closing differed from the MTD closing in that contracts were entered into under both original and revised CAS 413, the COFC reached the same conclusion on the issues of failure to fund, LOC-LOF, release, and profit and fee.

The COFC then explained the segment-closing ramifications of the FAR CAS Clause, 52.230-2(a)(4)(I), which calls for an equitable adjustment if a contract cost is affected by a change in accounting practice mandated by the clause's provision requiring the contractor to "comply with any CAS (or modifications to CAS) which hereafter become applicable to a contract or subcontract" Such a change occurs as the result of a segment closing involving contracts under both the original and revised CAS 413.

Teledyne addressed the CAS-Clause equitable adjustment as it applied to a segment closing involving a pension surplus yielding contractor liability, rather than a pension deficit yielding Government liability, as is the case for ESG. The *Teledyne* segment closing involved contracts under both CAS 413 versions. The Court held that because the segment closing in that case involved contracts entered into after CAS 413 revision, a segment-closing adjustment was not impermissibly retroactive. That ruling, however, "was tied" to the CAS-Clause provision for an equitable adjustment, the *Teledyne* court said.

The COFC, in *Teledyne*, explained that the revision to CAS 413 changed the parties' expectations and accounting practices for contracts that did not include revised CAS 413, and, therefore, amounts to a change in accounting practice under the CAS Clause. Thus, *Teledyne* was entitled to "an equitable adjustment in the amount of the pension surplus for which *Teledyne* is liable under [revised CAS 413] that is over and above the amount for which *Teledyne* would have been liable under the original [CAS 413]."

In *Viacom*, the COFC rejected the contractor's argument that the concern about retroactivity should

not limit the Government's liability. The COFC held that, to maintain the parties' long-standing expectations, an equitable adjustment is proper if the segment closing under CAS 413 results in a surplus or a deficit. Thus, if pension costs are attributable to contracts predating revised CAS 413, the contractor and the Government are entitled to an equitable adjustment if they have more liability under revised CAS 413 than they would have under original CAS 413.

The COFC distinguished *Kearfott Guidance & Navigation Corp. v. Rumsfeld*, 320 F.3d 1369 (Fed. Cir. 2003), which Viacom cited as support for limiting the benefits of the *Teledyne* holding to contractor equitable adjustments. *Kearfott* addressed a challenge to applying a FAR provision to a business combination that predated the regulation. The Federal Circuit held that because the parties entered into the contract after the business combination, the FAR provision did not affect vested rights and could apply to the contract.

Kearfott's rationale does not apply to the Viacom facts, the COFC said. Viacom and the Government entered into contracts under original CAS 413, thus creating expectations *before* CAS 413 was revised. Revised CAS 413 adjusts pension costs under contracts that do not include the revised CAS language, making *Kearfott* inapposite. The COFC also noted that the Federal Circuit, in affirming *Teledyne*, had similarly recognized that applying the original CAS 413 segment-closing adjustment to pensions costs attributable to contracts entered into before original CAS 413 was promulgated amounts to an accounting change and triggers an equitable adjustment.

Finally, the COFC rejected Viacom's assertion that the Government should comply with its regulations despite changes to preexisting expectations. The CAS clause is intended to maintain contract expectations and prevent windfalls, not protect contractors. "Here, the government happens to be the beneficiary of the equitable adjustment because a portion of the deficit includes pension costs attributable to fixed-price contracts that were not previously subject to the revised CAS 413," the COFC said.

◆ **Practitioner's Comment**—Pension cost allocation and adjustment due to a segment closure under CAS 413-50(c)(12)—both the original and as revised in 1995—have been of great interest for more than a decade. In large part, the *Viacom* decision is a non-

event, because both the Government and the contractor effectively sought the COFC to reconsider its decisions in the *General Motors* (involving an underfunded plan) and *Teledyne* (involving a plan surplus) cases; not surprisingly, the COFC followed those prior decisions. To a certain extent, however, the *Viacom* case expands on preexisting case law. The COFC held in *General Motors* that a contractor's failure to fund a pension in order to recover a deficit from the Government is not a bar to adjustment under original CAS 413; here, the COFC held that it is not a bar to adjustment under revised CAS 413, either. Similarly, the COFC applied *Teledyne* to *Viacom*, holding that the 1995 CAS 413 revisions constituted a change in accounting practice that affects adjustments for a pension deficit as well as a surplus.

The COFC also held, though only barely mentioned, that original CAS 413 does not contemplate cost adjustments for subcontracts affected by a segment closing because (1) it was silent on the issue, while the revised version specifically addresses this, and (2) the Government only indirectly contributes to subcontractors' pension plans through the prime contractor. CAS and CAS regulations apply to nonexempt subcontracts as well as prime contracts. 48 CFR 9903.201-1. Accordingly, when a contractor's segment containing CAS-covered subcontracts closes, those subcontracts must comply with CAS 413-50(c)(12). The COFC seems to suggest that any subcontract adjustments will have to be resolved through the prime contractor, to the extent that the subcontract is subject to the original CAS 413. The passage of time may make such an event unlikely, but, should it arise as in *Viacom*, it will present interesting subcontract interpretation issues.

Finally, it is important to note that Raytheon was an amicus curiae in the *Viacom* case. Raytheon has a segment-closure case with similar issues pending before the COFC. Nevertheless, Raytheon's case presents independent issues on the implementation of the adjustment and the effect on post retirement benefits, so the Government contract community should stay tuned.



This PRACTITIONER'S COMMENT was written for THE GOVERNMENT CONTRACTOR by Paul E. Pompeo, a partner in the Government Contracts Practice at the law firm of Holland & Knight LLP, resident in the Washington, D.C. office.