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Close-Out Barred Segment Closing Adjustment; Pension Fund Merger Entitled Government To Share Of Surplus Assets

ICI Americas, Inc., ASBCA 54877, 55078 (May 23, 2007)

A bilateral contract close-out barred the Government's segment closing adjustment under Cost Accounting Standard 413. And a merger of overfunded pension plans with other corporate affiliate pension plans was a constructive receipt of surplus pension assets, which entitled the Government to receive its equitable share of the assets, the Armed Services Board of Contract Appeals has held.

Under a series of contracts beginning in 1972 and spanning about 25 years, ICI Americas Inc. (ICIA) operated two Government-owned, contractor-operated (GOCO) facilities, the Indiana Army Ammunition Plant (INAAP) and the Volunteer Army Ammunition Plant (VAAP). ICIA operated the plants as two separate segments for cost accounting purposes.

From 1972 through 1987, ICIA contributed to a stand-alone defined benefit pension plan for INAAP salaried employees. From 1972 to 1990, ICIA also contributed to a stand-alone pension plan for its INAAP bargaining unit employees. And from 1972 through 1987, ICIA contributed to a single VAAP employee defined benefit pension plan as part of the ICI Americas Pension Plan.

In 1991, the Government reviewed the INAAP pension plans for fiscal years 1988–1989 and found that the salaried plan was overfunded, i.e., the market value exceeded the actuarial liabilities. A year later, ICIA actuarial reports showed that both INAAP pension plans were overfunded. The VAAP component of the ICI Americas Pension Plan also was overfunded, as of 1997.

When ICIA merged INAAP pension-plan assets and liabilities into other ICIA corporate affiliate plans on Dec. 31, 2001, both INAAP pension plans were overfunded. ICIA also transferred the VAAP component of the ICI Americas Pension Plan into another ICIA corporate affiliate pension plan on Jan. 1, 2005.

The INAAP and VAAP pension plans were not terminated, and after the mergers their assets stayed in the same master trust. But when separate accounting ended for the VAAP pension plan after 1997 and the INAAP plans merged with other plans in 2001, the assets and liabilities of the INAAP and VAAP plans were commingled with other plans. As a result, the INAAP and VAAP plan surpluses were available to pay benefits to participants in the merged plans regardless of where they had worked.

The Government has no liability for future shortfalls in the merged pension plans, but, after liquidating the merged plans' remaining liabilities, any future surplus would likely revert to ICIA or its corporate affiliate. The plans did not provide that surplus assets would revert to the Government when the plans were liquidated.

On Sept. 21, 2004, the contracting officer issued a final decision demanding a CAS 413 segment closing adjustment for the overfunded pension plans for INAAP and VAAP employees. The CO estimated the amount due as $80 million plus interest.

The CO issued another final decision April 22, 2005, stating a second ground for ICIA's liability: "constructive reversion" to ICIA of the surplus assets in the INAAP and VAAP pension funds. The final decision stated that the constructive reversion occurred after March 1999, when ICIA exercised control over the INAAP and VAAP pension plan assets by merging them with other plans' assets. According to the CO, the Government was entitled

to compensation under Armed Services Procurement Regulation 15-201.5 Credits, Federal Acquisition Regulation 31.201-5 Credits or FAR 31.205-6(j)(4) Termination of Defined Benefit Plans.

Segment Closing Adjustment—Although CAS 413.50(c)(12) looks to past contracts to calculate segment closing adjustments, "it calls for an adjustment in the current period at the time of the segment closing," the ASBCA stated, citing *Teledyne, Inc. v. U.S.*, 50 Fed. Cl. 155 (2001), aff'd, *Allegheny Teledyne, Inc. v. U.S.*, 316 F.3d 1366 (Fed. Cir. 2003); 45 GC ¶ 69. To permit a segment closing adjustment, "there must be an open, flexibly priced contract subject to CAS 413 in the current period of the segment closing to which the adjustment can be made as an increase or decrease in allowable cost," the ASBCA held.

Facilities Use and CTR Contracts: The parties agreed that the CAS Board regulations did not apply CAS 413 to some INAAP and VAAP contracts known as "facilities use" and "CTR" contracts. The ASBCA rejected the Government's argument that, under the FAR 31.205-6(j)(2) cost principle, CAS 413 applied to these contracts. FAR pt. 31 cost principles governed the contracts to the extent the Government ordered work that was "performed at Government expense." No such work was ordered under these contracts.

In addition, FAR 31.205-6(j)(2) provides that the "cost of all defined benefit pension plans shall be measured, allocated, and accounted for in compliance with the provisions of 48 CFR § 9904.412, Composition and Measurement of Pension Costs, and 48 CFR § 9904.413, Adjustment and Allocation of Pension Cost." Under these provisions, if a FAR cost principle, rather than a CAS regulation, makes CAS 413 applicable, it applies only if there are pension costs incurred under the contract to be "measured, allocated, and accounted for." There were no such costs on the INAAP and VAAP facilities use and CTR contracts, and thus there is no basis under the FAR cost principles for a CAS 413 segment closing adjustment.

GOCO Contracts: Of the three INAAP GOCO contracts, CAS 413 covered only the 1978 and 1986 contracts. The parties agreed to close the 1978 contract without exceptions five years before the 1993 INAAP segment closing. The 1986 contract was open at the segment closing date but was closed in 1998, with no adjustments and with the statement that "all contractual actions have been completed and there are no outstanding balances on this contract." This close-out agreement covered a segment closing adjustment, which is a contractual action. The ASBCA found that when the Government signed this agreement, it knew the INAAP pension plans were overfunded.

The Government could not avoid the INAAP close-out agreement by relying on cases holding that final payment does not bar a segment closing adjustment. The holding in those cases does not apply to a final payment with an express bilateral close-out agreement covering a segment closing adjustment.

An assignment-of-refunds provision included with the final payment procedure for the 1986 contract also did not allow the Government to avoid the close-out agreement. That provision assigned to the Government "all refunds, rebates, credits, and other amounts … arising out of the performance of the contract." Only the distribution of an actual pension fund surplus to ICIA would come within the assignment-of-refunds provision. The Government's claim sought an "actuarial (estimated) surplus that has not been (and may never be) distributed to ICIA," the ASBCA stated, holding that the Government was not entitled to a segment closing adjustment for the INAAP pension funds and sustaining the appeal in part.

The 1988 VAAP GOCO contract, however, was subject to CAS 413, open at the time of the June 1996 VAAP segment closing and not covered by a bilateral close-out agreement. Despite ICIA's contentions, a bilateral modification with a current estimated contract amount was not an agreement on the final contract price. In addition, final payment does not bar a Government claim with no express time limit if the claim is made in a reasonable time.

The Government's repeated efforts to get the information necessary to calculate the segment closing claim notified ICIA of a likely formal claim. When the VAAP segment closed, ICIA—not the Government—had the obligation to determine the difference between the value of the segment plans' actuarial liabilities and plan assets. ICIA's attempt to meet this obligation fell short, and the Government rejected ICIA's proposal with a detailed "14-page, paragraph-by-paragraph critique, to which the ICIA made no substantive response," the ASBCA found. Any delay asserting the segment closing claim was attributable to ICIA's insistence that its contracts were not subject to CAS 413 and its refusal to provide the data necessary to calculate the segment closing adjustment.

The ASBCA upheld the Government's entitlement to a VAAP segment closing adjustment.

Constructive Receipt of Assets—The CO's second decision asserted that ICIA constructively received surplus assets in the INAAP and VAAP pension plans when ICIA controlled the assets by merging the plans with other ICIA corporate affiliate plans. The CO based this claim on cost principles incorporated into ICIA's contracts: FAR 31.201-5 Credits; the predecessor regulation, ASPR 15-201-5 Credits; and FAR 31.205-6(j)(4) Termination of Defined Benefit Pension Plans.

FAR 31.201-5 Credits states that the "applicable portion of any income, rebate, allowance or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund." Citing Webster's Third New International Dictionary, the ASBCA held that "receive" means to "take possession or delivery" and "accrue" means "to come into existence as an enforceable claim."

Under the predecessor to the FAR 31.201-5 Credits cost principle, ASPR 15-201.5, the Government could recover surplus assets of a terminated defined benefits pension plan that the contractor actually received if they were allocable to Government-reimbursed costs. The ICIA pension surpluses, however, stayed in a master trust, and ICIA had no right to possession. Therefore, the Credits cost principle provided no basis for Government recovery of those surpluses.

The second cost principle urged by the CO as a basis for recovery, FAR 31.205-6(j)(4) Termination of Defined Benefit Pension Plans, states, "When excess or surplus assets revert to the contractor as a result of termination of a defined benefit pension plan, or such assets are constructively received by it for any reason, the contractor shall make a refund or give a credit to the Government for its equitable share of the gross amount withdrawn."

FAR 31.205-6(j)(4) did not apply to the GOCO contracts because they were awarded before the Sept. 30, 1989 effective date, and did not apply to the facility-use contracts because they had no "work performed at Government expense," a condition for applying FAR 31.205-6(j)(4). That provision did, however, apply to the INAAP CTR contract.

Although FAR 31.205-6(j)(4) does not define "constructively received," the immediately preceding subsection, FAR 31.205-6(j)(3)(v), states that transferring assets from one pension fund to another without an advance agreement constitutes a constructive withdrawal covered by FAR 31.205-6(j)(4).

The ASBCA held that there was "no substantial difference" between ICIA's merging the assets and liabilities of its INAAP plans with other corporate pension plans and the transfer of pension plan assets to another employee benefit plan, as discussed in FAR 31.205-6(j)(3)(v). The Government has an equitable claim on any surpluses in the INAAP plans when they are terminated, but by commingling them with other plans, ICIA "foreclosed the Government's ability to track in the future any surpluses that might have existed had the plans not been merged." When the merged plans are terminated, surplus assets likely will revert to ICIA because the Government will be unable to prove the portion of the surplus allocable to the pension costs it reimbursed, the ASBCA found.

Rejecting a litany of ICIA arguments, the ASBCA held that (1) FAR 31.205-6(j)(4) and CAS 413 address different issues, and the constructive receipt theory does not conflict with the *Allegheny Teledyne* decision on CAS 413; (2) although the INAAP GOCO contracts did not provide for Government recovery of "constructively received" pension plan surpluses, the 1993 INAAP CTR contract gave the Government that right; (3) the clause at FAR 52.215-27 Termination of Defined Benefit Pension Plans applies if the contractor constructively receives pension fund assets, even if the fund is not terminated; (4) while the INAAP plans remained in the same master trust, they were no longer exclusively dedicated to the INAAP plan beneficiaries; (5) merger of the plans made the funds available to pay pensions to employees other than those who worked on INAAP contracts and conflicted with the terms for Government reimbursement of pension costs; and (6) the clause at FAR 52.215-27 Termination of Defined Benefit Pension Plans, contained in the 1993 INAAP CTR contract, put no time limit on the contractor's obligation to compensate the Government for its equitable share if the contractor constructively receives pension fund assets.

After holding that the constructive receipt theory supports Government recovery of surpluses in the INAAP pension funds, the ASBCA held that no such right exists for the VAAP pensions. The VAAP GOCO contract preceded the FAR 31.205-6(j)(4) effective date and the associated contract clause at FAR 52.215-27. And, although the 1994 VAAP facilities use contract incorporated FAR 31.205-6(j)(4) by reference, that regulation did not apply because that contract did not have "work performed at Government expense," the ASBCA held, sustaining the appeal in part.

✦ **Practitioner's Comment**—The *ICI Americas* case addresses new issues in the area of pension accounting. As it relates to the requirements for segment closure accounting under CAS 413, the decision is somewhat unremarkable. The decision is particularly important regarding constructive receipt of pension assets and will be of special interest to contractors who have or are contemplating merger of pension plans. Indeed, the concepts in FAR 31.205-6(j)(4) on adjustments for plan terminations and constructive receipt of plan assets have not been addressed in earnest since the near-forgotten *U.S. v. Bicoastal Corp.*, 125 B.R. 658 (M.D. Fla. 1991). Contractors may be inclined to merge an underfunded plan with one that has surplus assets; however, under *ICI Americas* that might trigger constructive receipt of those assets under the FAR—even though tax law might conclude otherwise.

The *ICI Americas* case also is important for an evidentiary ruling not discussed in the briefing above. The ASBCA admitted reports of experts in accounting and pension, despite the prohibition under *Rumsfeld v. United Tech. Corp.,* 315 F.3d 1361 (Fed. Cir. 2003), holding that the Board would "afford individual portions the appropriate weight in light of the parties' objections." The consequence is that the Board would have the benefit of the entirety of the reports to assist its interpretation of the regulations and CAS. This is an innovative way to reconcile the troubling decision in *United Tech.*, with a legitimate need for testimony on application of the CAS and cost principles.

Finally, the case was bifurcated for entitlement and quantum. Because the Board sustained the appeal in part and denied it in part regarding the segment closure accounting, and because ICI Americas already had merged the pension plans, it may be near impossible to determine the segment closure adjustment and the constructive receipt allowance. It is likely that the *ICI Americas* case will reappear at the Board, if not also at the Federal Circuit.

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This Practitioner's Comment was written for The Government Contractor by* Paul Pompeo, *a partner at Arnold & Porter LLP.