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COFC Addresses Actuarial Assumptions For Segment Closing Adjustment

General Motors Corp. v. U.S., 2007 WL 2753328 (Fed. Cl. Sept. 14, 2007)

Original Cost Accounting Standard 413.50(c)(12) requires a contractor to use actuarial assumptions under CAS 412.40(b)(2) to calculate a segment's actuarial liability for the purpose of a segment closing adjustment if the pension plan does not terminate, the U.S. Court of Federal Claims has held.

In 1993, General Motors Corp. sold its Allison Gas Turbine Division, which had defined-benefit pension plans. GM did not terminate the plan, and retained all liabilities and assets. The sale constituted a segment closing under CAS 413, which triggered a requirement for an adjustment to GM's pension costs to account for the closed segment's pension surplus or deficit. To permit this adjustment, original CAS 413.50(c)(12) required GM to calculate the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment. Under this provision, the Government is liable for its share of a pension deficit and is entitled to recoup its share of a pension surplus.

The parties agreed that there was a pension deficit, but disagreed on the amount of the deficit and assumptions used to calculate the actuarial liability for the closed segment. These actuarial assumptions concern the interest rate that pension assets will earn and plan participants' mortality rate.

GM argued that because the contractual relationship between the Government and the closed segment ends, a segment closing is analogous to a plan termination. GM further contended that under CAS 413 a final settlement will occur, relieving the Government of future risks on the closed segment's pension obligations. According to GM, CAS 413 requires the use of Pension Benefit Guarantee Corp. (PBGC) actuarial assumptions, including interest rates of 5.6 percent for the first 25 years and 5.25 percent for later years, and mortality assumptions based on the 1983 Group Annuity Mortality Table.

The Government urged the COFC to apply the actuarial assumptions that GM developed for its annual accounting of pension costs, as required by CAS 412. These assumptions include a nine-percent interest rate and mortality assumptions based on the UP-84 Mortality Table. Under the Government's interpretation, the pension deficit and the Government's share of that deficit are much lower.

In adopting the Government's argument, the COFC focused on the language of CAS 412 originally promulgated in 1975, see 40 Fed. Reg. 43876, and CAS 413, originally published in 1977, see 42 Fed. Reg. 37196. These provisions govern the contracts in this case, which predate the 1995 revisions to CAS 412 and 413.

Original CAS 413.50(c)(12) provides, "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 ... the pension is terminated."

CAS 413.30(a)(4) defines "actuarial liability" as:

> pension cost attributable, *under the actuarial cost method in use*, to years prior to the date of a particular actuarial valuation. As of such date, the actuarial liability represents the excess of the present value of the future benefits and the administrative expenses over the present value of future contributions for the normal cost for all plan participants and beneficiaries. The excess of the actuarial liability

> over the value of the assets of a pension plan is the unfunded actuarial liability.

(Emphasis added.)

CAS 413.30(a)(2) defines "actuarial cost method" as a technique that "uses *actuarial assumptions* to measure the present value of future benefits" (emphasis added). And an "actuarial assumption" is a "*prediction of future conditions affecting pension cost*; for example, mortality rate, employee turnover, compensation levels, pension fund earnings, change in values of pension fund assets." CAS 413.30(a)(1) (emphasis added).

CAS 413 definitions refer to the actuarial cost method in use and the prediction of future conditions. The definitions thus refer back to CAS 412.40(b)(2), which requires contractors to use actuarial assumptions reflecting their prediction of future conditions when they seek reimbursement of their pension costs. CAS 412.40(b)(2) provides in relevant part, "Each actuarial assumption used to measure pension cost ... shall represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations." CAS 412 and CAS 413 use the same definition of "actuarial assumption," the COFC wrote.

The COFC said that "under CAS 413 a contractor is required to determine its pension liability based on the actuarial assumptions it developed under the cost method it used under CAS 412 prior to the segment closing." Because the cost method developed under CAS 412 is the only cost method previously in use, "the actuarial assumptions developed under CAS 412 are the actuarial assumptions referenced in CAS 413.50(c)(12)," the COFC held.

The COFC then rejected a string of GM arguments. First, the segment closing "settlement" did not necessitate use of actuarial assumptions designed for a plan termination. The language of CAS 413 and its preamble make clear that a segment closing adjustment is independent of a plan termination. While the Government and the contractor do "settle" the Government share of the pension liabilities, a segment closing differs from a plan termination. For example, unlike a plan termination, a segment closing does not settle the pension liability with plan participants.

Although, for plan terminations, CAS 413 and its preamble permit the use of valuation rules mandated by regulations implementing the Employee Retirement Income Security Act, those rules do not apply in a non-termination context. If a plan terminates, ERISA requires contractors to "provide all benefits liabilities under the plan," and CAS 413 recognizes the Government's obligation for its share of these payments. If, however, the plan does not terminate, and the ERISA requirement does not apply to GM, "there is no reason to apply the ERISA requirement to the calculation of the segment-closing adjustment," the COFC said.

In addition, the CAS 413 preamble explains that a segment closing addresses the potential that under CAS 412, a contractor may have overestimated or underestimated its pension costs and may have amortized them over 15 years. Because a segment closing prematurely ends the amortization, CAS 413 requires an adjustment to previously determined pension costs. Nothing in the preamble supports GM's argument that a segment closing adjustment accounts for Government relinquishment of all risk for future pension costs, the COFC held.

Because CAS 413 requires the contractor to "determine the difference between the actuarial liability for the segment and the *market value* of the assets allocated to the segment," GM argued that actuarial liability should be calculated using actuarial assumptions, such as the PBGC assumptions, that best reflect the market rate (emphasis added).

Whatever merit GM's policy and economic arguments may have, the language of CAS 413 does not support GM's interpretation. The CAS 413 definitions related to actuarial liability dictate that contractors use CAS 412 assumptions, the COFC held.

Moreover, along with language nearly identical to the operative language in original CAS 413, the 1995 CAS 413 revisions contain new language that makes clear the intent to use ongoing plan assumptions rather than market assumptions, if there is no plan termination, the COFC held.

> If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the actuarial accrued 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.
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> *The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs*. If there is a pension plan termination, the actuarial accrued liability shall be measured as

> the amount paid to irrevocably settle all benefit obligations or paid to the Pension Benefit Guarantee Corporation.

Revised CAS 413-50(c)(12) (emphasis added).

Although 1995 CAS Board actions do not conclusively establish the original CAS Board's intent, the 1995 revisions reveal the 1995 Board's interpretation of original CAS 413, the COFC wrote, relying on U.S. Supreme Court precedent giving interpretive weight to subsequent legislative pronouncements. See *Red Lion Broadcasting Co. v. Federal Communications Comm'n,* 395 U.S. 367 (1969).

Finally, the COFC rejected GM's argument that in other circumstances the Government or its representatives had relied on PBGC rates, applied other ERISA requirements, or compared a segment closing adjustment to a termination. This evidence did not establish that the Government had asserted that PBGC actuarial assumptions are required in a CAS 413 segment closing adjustment if the pension plan continues. The language of CAS 413.50(c)(12) requires GM to use its actuarial assumptions under CAS 412.40(b)(2) to calculate its liability for the segment closing adjustment, the COFC held in granting the Government's motion for partial summary judgment.

✦ **Practitioner's Comment**—As the COFC notes in its decision, the *GM* case is one of a number of related CAS 413 segment closure decisions the court has issued. Having addressed the fundamental issues of what constitutes a segment closure, the cases have narrowed to the more specific detail of determining the method for calculating the actuarial liability and market value of assets. This case demonstrates that the actuarial assumptions employed to determine the actuarial liability can profoundly affect the determination of whether there is, and the amount of, a pension "surplus" or "deficit."

The COFC takes a plain-reading approach to interpreting the CAS and finds that a contractor must use the ongoing assumptions employed for purposes of CAS 412 pension accounting in the event of a segment closure, unless there is a plan termination. Interestingly, the COFC seems to divert somewhat from its prior decisions that make definitive distinctions between the original CAS 413 and CAS 413 as revised in 1995. The COFC made clear in *Teledyne, Inc. v. U.S.*, 50 Fed. Cl. 155 (2001), that segment closures occurring before 1995 are subject to the original CAS, and those after are subject to the revised standard, seemingly interpreting the two as sufficiently distinct to warrant separate application. Nevertheless, in interpreting the original CAS 413, the COFC is persuaded by the revised CAS 413 as to the intent of the original CAS. Although the COFC relies on certain Supreme Court cases for the proposition that subsequent legislation may be considered in interpreting earlier law, the Supreme Court has also held that "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *Consumer Prods. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 117 (1980) (citing *U.S. v. Price*, 361 U.S. 304, 313 (1960)). In light of the prior distinction, one would have expected the COFC to have stuck to it, but, in the end, reliance on the revised CAS 413 may not have altered the ultimate conclusion.

The *GM* case addresses some issues handled ten years earlier in the Armed Services Board of Contract Appeals decision in *Gould, Inc.*, ASBCA 46759, 97-2 BCA ¶ 29254, to which the COFC makes passing reference. In *Gould,* the board analyzed the actuarial assumptions to employ in a segment closure accounting under original CAS 413. The board similarly held that the ongoing assumptions for CAS 412 accounting should apply, but that the reasonableness of the assumptions should be evaluated case by case under the circumstances of a segment closure. Hence, the board individually analyzed the actuarial assumptions at issue and determined, in most instances, that they should be the ongoing CAS 412 assumptions; in at least one case, however, an adjustment to an assumption was appropriate.

Much is at stake in this case economically. GM's 2003 petition to the Supreme Court from the consolidated *Teledyne and GM* decision out of the Federal Circuit indicates that GM estimated the "deficit" at $311 million, but the *Teledyne* decision that there can be no adjustment to fixed-priced contracts under an original CAS 413 segment closure reduced GM's entitlement by more than $200 million. Presumably, the disputed actuarial assumptions will have a substantial impact on any adjustment to which GM would be entitled. This alone is reason to expect that there will be further proceedings in this matter.

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This Practitioner's Comment was written for The Government Contractor by Paul E. Pompeo, a partner in the Government contracts practice of Arnold & Porter LLP.