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COFC Addresses Segment Closing Adjustment For Partial Transfer Of Pension Assets And Liabilities

Gen. Elec. Co. v. U.S., No. 99-172C (Fed. Cl. Sept. 29, 2008)

If a contractor closes a segment, the Cost Accounting Standards require the contractor to calculate the segment's pension assets and liabilities to determine the part of the surplus or deficit attributable to the Government's pension contributions. For contracts covered by original CAS 413, if a contractor sells a segment but retains part of the pension assets and liabilities, the contractor must calculate a segment closing adjustment on the entire segment. The calculation should consider the benefit the Government will receive from surplus pension assets transferred to the buyer, the U.S. Court of Federal Claims has held.

Since the early 1900s, General Electric Co. has maintained a defined-benefit pension for its employees, known as the GE Pension Plan (GEPP). The Government reimbursed GE's pension contributions attributable to employees working on Government contracts. Because the GEPP has had a pension surplus, GE has not made pension contributions since 1987.

In 1992, Martin Marietta Corp. purchased GE's aerospace business segment (GEA), and in April 1993, more than 30,000 employees and the associated pension assets and liabilities transferred to Martin Marietta. GE also sold its machinery apparatus operation (MAO) business segment to Westinghouse Electric Corp., and 395 active employees and associated pension assets and liabilities

transferred to Westinghouse. GE kept the pension obligations for employees, including retirees, who had worked in the transferred segments, but were not transferred. The COFC previously determined that the sales constituted segment closings. *Teledyne, Inc. v. U.S.*, 50 Fed. Cl. 155 (2001), *aff'd sub nom. Allegheny Teledyne, Inc. v. U.S.*, 316 F.3d 1366 (Fed. Cir. 2003), *cert. denied, Gen. Motors Corp. v. U.S.*, 540 U.S. 1068 (2003).

CAS 413 requires contractors to amortize actuarial gains and losses over 15 years to permit annual adjustments to pension costs and thus account for previous years' gains and losses. If a segment closes, there are no future periods in which to adjust previously determined pension costs. CAS 413.50(c)(12) therefore provides for a segment closing adjustment to settle pension costs. At the time of a segment closing, a contractor must calculate a segment closing adjustment on the segment's pension assets and liabilities to determine the portion of the surplus or deficit attributable to the Government. The Government is entitled to its share of a pension surplus.

GE calculated its pension costs based on the assumptions that covered employees would work for GE their whole careers, and the amount invested would be sufficient to cover the pension liability for those employees. Inaccuracies in these assumptions could result in excess or insufficient contributions.

Martin Marietta assumed all GEA Government contracts on March 29, 1993. Pursuant to an advance agreement with the Government, GE pension assets and liabilities were transferred to a trust designated by Martin Marietta. After that transfer, the pension liabilities for active GEA employees were Martin Marietta's responsibility, and GE kept the untransferred pension assets and liabilities in the GEPP. GE made a similar transfer for the MAO sale to Westinghouse.

In March 1998, GE submitted its segment closing adjustment calculations to the contracting officer, and later claimed \$539.2 million plus interest for pension and post-retirement medical benefit

costs. In February 1999, the CO alleged that GE had not complied with the CAS, and claimed \$530.7 million plus \$419.4 million in compound interest. The Government calculated its segment closing adjustment based on the pension assets and liabilities retained by GE, and demanded a full cash payment.

Segment Closing Adjustment Based on Entire Segment—The contract at issue predates the 1995 CAS 413 revisions and is governed by original CAS 413. The COFC explained that the purpose of the CAS 413 adjustment is to account for excess or deficient Government reimbursement of pension costs attributable to flexibly priced contracts performed by the entire segment. The plain language of this provision requires that the segment closing adjustment calculation be performed on the basis of the entire segment, rather than on pension assets and liabilities retained by the contractor, as the Government contended. The COFC noted that original CAS 413 repeats the word “segment” nine times:

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. ... In computing the market value of assets for the *segment*, if the contractor has not already allocated assets to the *segment*, such an allocation shall be made in accordance with the requirements of paragraph (c)(5)(i) and (ii) of this section. The market value of the assets allocated to the *segment* shall be the *segment's* proportionate share of the total market value of the assets of the pension fund. The calculation of the difference between the market value of the assets and the actuarial liability shall be made as of the date of the event (e.g., contract termination) that caused the closing of the *segment*. ... The difference between the market value of the assets and the actuarial liability for the *segment* represents an adjustment of previously determined pension costs.

(Emphasis added by Court.)

This interpretation comports with the COFC's previous holding that under the CAS a contractor establishing a segment may not exclude employees who are associated with a segment, and that a contractor may not carve out a new incomplete segment from another segment. *Gen. Elec. Co. v. U.S.*, 60 Fed. Cl. 782 (2004).

The COFC also rejected the Government's assertion that prior decisions allow segment closing adjustments based on less than the entire segment. *Teledyne* and *Allegheny Teledyne* recognized that an adjustment calculation is not proper for some previously determined costs, such as employee contributions, or for fixed-price contracts. Employee contributions are not Government contributions and therefore present no basis for an adjustment for the Government's benefit. Similarly, the original CAS do not allow an adjustment to pension costs that were fixed because they were paid by the Government under fixed-price contracts.

The Government's reliance on the language of new CAS 413.50(c)(12)(v) to support its interpretation of original CAS 413.50(c)(12) was misplaced, the COFC said. The 1995 amendment to CAS 413 provides that if “only some of the pension plan assets and actuarial accrued liabilities of the closed segment are transferred, then the adjustment amount required under this paragraph (c)(12) shall be determined based on the pension plan assets and actuarial accrued liabilities remaining with the contractor.” *Allegheny Teledyne* makes clear that the 1995 amendments were substantive and not properly viewed as mere clarifications of original CAS 413 requirements. The new CAS 413 requirement that, for a partial surplus transfer, a segment closing adjustment should be performed based on the pension assets and liabilities remaining with the contractor changes the original CAS requirement that a segment closing adjustment be performed based on the segment. Thus, original CAS 413 cannot be read to encompass the provisions of new CAS 413. The segment closing adjustment required under original CAS 413 must include the pension assets and liabilities transferred to the buyer of the segment, the COFC held.

Government Must Consider Benefits from the Transferred Pension Surplus—The parties did not dispute that the Government benefited from the transferred pension surplus, which reduced the Government's future pension costs, but they disagreed on the amount of the benefit. The COFC held that the Government must give a seller credit toward its segment closing adjustment to account for the benefit that the Government receives from the transfer of excess pension assets and liabilities to the buyer.

CAS authorizing legislation makes clear that the CAS protect the Government from paying increased costs as a result of a segment closing and

prohibit the Government from receiving a windfall. See 41 USCA §§ 422(h)(1)(B), 422(h)(3). Section 422(h)(1)(B) provides that a contractor shall “agree to a contract price adjustment, with interest, for any increased costs paid to such contractor ... by reason of a change in the contractor’s ... cost accounting practices or by reason of a failure by the contractor ... to comply with applicable cost accounting standards.” Section 422(h)(3) limits the Government’s recovery under the segment closing adjustment by providing that in “no case shall the Government recover costs greater than the increased cost ... to the Government, in the aggregate.” In light of these provisions, if a transferred surplus reduces the Government’s future pension costs, that benefit must be considered in the segment closing adjustment to avoid a Government windfall.

Contrary to the Government’s argument, addressing GE’s entitlement to such a credit does not involve CAS interpretation. Instead, it presents a question of the mechanism used to compensate the Government for its share of the pension surplus. This payment issue is not covered by the CAS, the COFC said.

Department of Defense guidance supports GE’s contention that a pension surplus transfer may be used to satisfy a seller’s segment closing obligation. Both the DOD inspector general and the Defense Logistics Agency have acknowledged that a contractor can satisfy its segment closing adjustment obligation by transferring funds to the buyer’s pension fund. Moreover, under the Credits clause, Federal Acquisition Regulation 31.201-5, a contractor may satisfy its segment closing adjustment obligation through a cost reduction or by cash refund, the COFC said. The Government’s contention that the Credits clause always requires that the cost reduction be achieved through contracts held by the seller contradicts the DOD guidance. The COFC concluded that, “in appropriate circumstances,” if the Government reviewed and approved segment sales and the transfer of pension assets and liabilities, including a surplus, “satisfaction of the CAS 413 segment closing adjustment may be achieved through the cost reduction the government will receive from its contracts with the buyer.”

The COFC did not determine the precise amount of the credit GE should receive because additional factfinding on that issue is necessary.

♦ **Practitioner’s Comment**—Much of this round of the *GE* case seems uneventful. The COFC already resolved in the *Teledyne* series of decisions some of the issues that the parties raised in *GE*, such as whether the 1995 version of CAS 413.50(c)(12) was a mere clarification of original CAS 413.50(c)(12). It is surprising that the parties would raise the same arguments before the very judge who decided the *Teledyne* cases. There is, however, a noteworthy aspect of this decision: the concept of a windfall regarding the segment closure adjustment itself, and restriction on increased costs to the Government in the aggregate as a consequence of a change in cost accounting practice or noncompliance with the CAS.

As discussed above, plaintiffs in *GE* argued that the segment closure adjustment under CAS 413.50(c)(12) must take into account surplus assets that a contractor transfers to the acquiring entity. To do otherwise would constitute a windfall to the Government, according to plaintiffs. The COFC agreed. To arrive at this conclusion, the COFC relied on a provision in the enabling act that has a greater ramification for the concept of increased cost to the Government in the aggregate. The statute states that there shall be no increased cost to the Government in the aggregate due to a change in cost accounting practice or failure to comply with the CAS; it does not address the adjustment unique to a segment closure under CAS 413.50(c)(12). The COFC interpreted that restriction to be a statement of policy that the Government cannot receive a windfall. The COFC then took that general statement of policy and applied it to the segment closure adjustment. By following this analysis, however, the COFC specifically has held that the Government cannot receive a windfall if there is a change in cost accounting practice or a noncompliance with the CAS. Thus, the COFC has clarified two CAS issues, whether it intended to do so or not, in one fell swoop. Indeed, measuring the cost impact due to a change in cost accounting practice and the concept of increased cost to the Government remain agenda items of the CAS Board. Let us see what the next round of the *GE* case brings.



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