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FEATURE COMMENT: ASBCA—'In The Aggregate' For Calculation Of CAS Cost Impact Must Include Fixed-Price And Flexibly Priced Contracts

Raytheon Co., ASBCA 56701, 2011 WL 1367446 (March 31, 2011)

On March 31, the Armed Services Board of Contract Appeals granted summary judgment in favor of Raytheon Co., denying a Government claim for $40 million plus continuing interest. The case addressed a critical issue under the Cost Accounting Standards: how to calculate the cost impact resulting from a change in accounting practice under CAS.

Although the case involved a change in the method of measuring the actuarial valuation of assets (AVA) for a contractor pension plan, the ruling interprets the meaning of "in the aggregate" under the CAS statute, 41 USCA § 422(h)(3), and the implementing CAS rules at 48 CFR § 9903.306(e), for the calculation of whether there are increased costs paid by the Government consequent to a change in cost accounting practice. The ASBCA held that the cost impact on fixed-price CAS-covered contracts must be aggregated with (or offset by) the cost impact on flexibly priced CAS-covered contracts. Additionally, the ASBCA spoke on the issue of affected contracts, holding that any price adjustment "is limited to the CAS-covered contracts in effect at the time the accounting change was made." Slip op. at 10. For this reason, the Government cannot incorporate the speculative effect on future contracts. Id.

The Facts of the *Raytheon* Matter—In 2001, Raytheon proposed changing the method by which it would measure the AVA for a particular pension plan, the cost of which Raytheon charged to CAS-covered Government contracts. Id. at 2. In 2002, a Defense Contract Insurance/Pension Review (CIPR) team recommended to the Defense Contract Management Agency that it accept the recommendation to change the AVA methodology. Id. at 3. It was not until 2003 that DCMA notified Raytheon that the Government approved of the change. Id. Because of the delay in receiving Government approval, Raytheon planned to implement the AVA change with a Jan. 1, 2004 effective date. Id. at 4.

Upon learning that Raytheon had not made the proposed cost accounting change effective Jan. 1, 2001, DCMA asserted that the original method of calculating the AVA was noncompliant with CAS and directed Raytheon to submit a cost impact statement for the alleged noncompliance. Id. Raytheon denied that it was noncompliant, and the dispute continued into 2004. The Government ultimately agreed that the original practice was compliant and acknowledged the Jan. 1, 2004 start date for the new method. The Government nevertheless instructed Raytheon to submit a cost impact proposal. Id. (The Government had reviewed Raytheon's 2001 proposal, the CIPR team recommended that the Government accept the proposal, the Defense Contract Audit Agency found it acceptable for negotiation, and DCMA determined that there was no cost impact, id. at 3, yet sought another cost impact statement.) In 2005, Raytheon prepared a proposal that offset the effect on fixed-price contracts against the effect on flexibly priced contracts at the time of the change in accounting practice and determined that there were no increased costs in the aggregate to the Government. Id. at 4.

In 2008, DCMA made a claim for over $40 million plus over $12 million in interest from Raytheon. The Government considered only the impact on fixed-price contracts, plus profit and fee on flexibly priced contracts. The Government excluded from its calculation the more than $57 million (DCAA's calculation) by which Raytheon's pension costs would *decrease* on flexibly priced

contracts. Id. at 5–6. Importantly, the Government argued that only "actual costs" should be considered, because actual costs would be recovered by flexibly priced contracts, so such contracts should not be part of the equation. It also argued that Raytheon might recover pension costs "embedded" in the fixed-priced contracts under some future fixed-price contracts because of the change in the method of measuring the AVA, warranting adjustment only to fixed-price contracts. Id. at 7, 10.

Increased Costs in the Aggregate—The centerpiece of the ASBCA's decision was the relevant language of the CAS statute and the implementing regulation. The CAS statute at 41 USCA § 422(h)(3) protects the Government from paying increased costs if a contractor changes its accounting practice, and it also states that the Government must consider all affected contracts in determining its costs. "In no case shall the Government recover costs greater than the increased cost (as defined by the [CAS Board]) to the Government, in the aggregate, on the relevant contracts subject to the price adjustment." Id. at 8 (citing 41 USCA § 422(h)(3)). Regarding calculation of the cost impact for a change in accounting practice, the CAS regulation at 48 CFR § 9903.306(e) states that if such a change increases the costs paid under some contracts while decreasing the costs paid under others, "the Government will not require price adjustment for any increased costs paid by the U.S., so long as the cost decreases under one or more contracts are at least equal to the increased cost under the other affected contracts." The ASBCA gave particular emphasis to this language in its ruling. Id. at 9.

In this case, the Government's claim cited two contracts, a fixed-price contract and a flexibly priced contract, from the relevant time period as examples of contracts for its allegation that Raytheon's change in AVA methodology immediately led to increased costs to the Government. Both of these contracts incorporated the Federal Acquisition Regulation 52.230-2 CAS clause incorporating 48 CFR § 9903.306, which, as described above, states that a price adjustment is not necessary after a change in accounting practice if cost decreases equal or exceed cost increases on affected contracts. Id. at 3, 4.

The question of what constitutes "increased costs in the aggregate" under CAS has escaped precise definition for years. Early Government policy acknowledged that, "[w]hile the parties to a fixed price contract have agreed to a total price, there is often no agreement as to how much of the price represents cost and how much profit," and so it was not possible to try to trace a particular cost element in a fixed-priced contract. DOD Working Group Item 76-9 (Dec. 17, 1976), reprinted in Cost Accounting Standards Guide (CCH) ¶ 5990.09.

The U.S. Court of Federal Claims confronted the issue in *Lockheed Martin Corp. v. U.S.*, 70 Fed. Cl. 745 (2006); 48 GC ¶ 135. In addressing a change in the method by which pooled costs were allocated to cost objectives under CAS 418, the court in *Lockheed* held that § 9903.306(e) requires that the increased/decreased costs paid by the Government for flexibly priced and fixed-price contracts be combined to determine whether there were increased costs in the aggregate paid by the Government. 70 Fed. Cl. at 752–53; see also *Astronautics Corp. of Am.*, ASBCA 49691, 99-1 BCA ¶ 30390; 41 GC ¶ 245 (Government advocated offsetting fixed-price and flexibly priced type contracts in the context of a CAS noncompliance).

The Government urged the ASBCA to consider only the impact on fixed-price contracts in this case and alleged that Raytheon would realize a "windfall profit" if the calculation was not limited to fixed-price contracts. The Government argued that Raytheon might somehow charge these costs again on future fixed-price contracts. Slip op. at 10. Raytheon, however, demonstrated that no windfall profit would ensue when the cumulative impact of fixed-price and flexibly priced contracts in the aggregate is considered. The Government itself acknowledged that it would benefit by over $57 million in savings as a result of decreased costs on flexibly priced contracts. Id. at 5, 10. The ASBCA found no basis to ignore these savings and limit the calculation to fixed-price contracts. The ASBCA cited *Lockheed* for the proposition that

> [t]he statute expressly provides that a price adjustment for a contractor's accounting practice change is "to protect the United States from payment, in the aggregate, of increased costs" and "[i]n no case shall the government recover costs greater than the increased cost ... in the aggregate, on the relevant contracts subject to the price adjustment."

Id. at 9–10. The ASBCA similarly ruled that "[t]he law requires a price adjustment for an accounting change only when the Government pays increased costs 'in the aggregate' considering all contracts affected by the change." Id. at 10.

The ASBCA found the provisions of the statute and regulations to be "express and unambiguous" on the issue, and unequivocally held that the impacts on fixed-price and flexibly priced contracts must be combined to determine the impact in the aggregate:

> [t]he fact that the government may not underpay the allocable costs on the flexibly-priced contracts resulting from the [AVA] change, however, does not change the fact that those allocable costs (as calculated by the government) would have been $57,209,821 higher if the accounting change had not been made.

Id. at 10.

Accordingly, under the plain language of the statute and regulations, a determination of increased costs in the aggregate must include an offset of fixed-price and flexibly priced contracts. The Government advanced various policy arguments against the application of the plain language, but the ASBCA found the statute and regulations unambiguous, and declined to ignore their terms:

> all of the government arguments appear to be addressed to the wisdom and policy of the statue and regulation. Our role is to apply the statute and regulations and not to determine whether some other approach would be better. *See McDonnell Douglas Corp.* ASBCA No. 19842, 80-1 BCA ¶ 14,223 at 70,052.

Id.

Affected Contracts—As noted above, also at issue in the case was the definition of "affected contracts" in calculating cost impacts, and specifically the potential applicability of future contracts to the calculation of aggregate impact to the Government. In support of its claim, the Government theorized that the new accounting method might lead Raytheon to price these pension costs into future contracts and thus these costs would be double-counted. Id. at 10. The Government insisted that it was entitled to estimate the amount of such future costs, and recover that amount now, as insurance against such potential double-counting. Raytheon argued that such a theory was highly speculative because it did not consider the potential effects of market activity, future contract mix, or many other factors that could render the Government's estimate inaccurate, and such an analysis impermissibly considered non-affected contracts, i.e. contracts priced after the institution of the new method.

The ASBCA agreed, ruling that

> [t]he argument of potential double charging is entirely speculative as to future pension fund performance and future contracts. In any event the price adjustment for consideration here is limited to CAS-covered contracts in effect at the time the accounting change was made. There is nothing in the record suggesting any double charging of pension costs to those contracts.

Id. Accordingly, the ASBCA reaffirmed the concept of an affected CAS-covered contract as one in effect at the time that the change was made. See also *Lockheed Martin Corp.*, ASBCA 53822, 07-2 BCA ¶ 33614 at 166,467, aff'd *Donley v. Lockheed Martin Corp.*, 608 F.3d 1348 (Fed. Cir. 2010); 52 GC ¶ 363 (holding that an affected CAS-covered contract "is one for which the contractor '[u]sed one accounting practice to estimate costs and a changed cost accounting practice to accumulate and report costs under the contract.' ").

Desirable Change—As the ASBCA explained, Raytheon argued in the alternative that the change in AVA method was a desirable change, which, under the FAR and CAS, would permit increased costs to the Government without a price adjustment. Slip op. at 7. 48 CFR § 9903.201-6(c)(2) states that a "[d]esirable change ... [is] not subject to the no increased cost prohibition provisions of CAS-covered contracts affected by the change," and that "[t]he change to a cost accounting practice may be determined to be desirable even though existing contract prices and/or cost allowances may increase." In other words, if the change in AVA methodology were "desirable," there would be no need to determine whether or not there were increased costs to the Government, as such increased costs would be permitted. The ASBCA did not reach this issue, stating that it was not necessary to do so, because there were ultimately no increased costs under a plain reading of the statute and regulations. Slip op. at 11. See generally *Lockheed Martin Corp.*, ASBCA 53822, 07-2 BCA ¶ 33614 at 166,469 (citing *PACCAR Inc.*, ASBCA 27978, 89-2 BCA ¶ 21696; DOD W.G. 79-23, reprinted in Cost Accounting Standards Guide (CCH) ¶ 5990.23) (discussing the standards for a desirable change).

Conclusion—The decision in *Raytheon* has implications far beyond the facts at issue. It stands for the proposition that increased and decreased costs on fixed-price and flexibly priced CAS-covered contracts in existence at the time of a change in accounting practice must be offset against one another

to determine whether there are increased costs in the aggregate. Although some might herald the *Raytheon* decision as a victory for contractors, this is something of an overstatement. The ASBCA properly applied a plain reading of the statute and regulations. Under a different set of facts, a mix of contracts and allocation might well result in *increased* costs in the aggregate, and potentially result in contractor liability. In this case, application of "the wisdom and policy of the statute and regulations," slip op. at 10, resulted in a proper determination that there were no increased costs to the Government—even under the Government's own calculation of the costs. What the ASBCA has made clear, however, is that it will not countenance manipulation of the plain language of the statute and regulations for a party to manufacture "some other approach [that would] be better" for its own position. Slip op. at 10.

[Editor's Note: Effective January 4, 41 USCA § 422 was recodified without change as 41 USCA §§ 1501–1506. The events underlying the case occurred before the recodification, and the ASBCA opinion cited to the earlier U.S. Code sections.]

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