

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --)
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E-Systems, Inc.) ASBCA Nos. 45771 and 46409
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Under Contract No. F33600-85-G-5007)

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OPINION BY ADMINISTRATIVE JUDGE MOED

Appellant (hereinafter "E-Systems") changed the method for valuation of real assets of its pension plans without amending its Cost Accounting Standards Board (CASB) Disclosure Statement in that respect. After learning of the change, the contracting officer determined that the same constituted a change in a cost accounting practice and, pursuant to the COST ACCOUNTING STANDARDS clause of the contract, FAR 52.230-3 (APR 1984) ("CAS clause"), she issued a written decision asserting a monetary claim for the alleged impact of that change in the form of increased costs paid by the Government. The appeal from that decision was docketed as ASBCA No. 45771. E-Systems paid the amount of the claim under protest and thereafter submitted a claim for refund of the payment. An appeal based on the deemed denial of that claim was subsequently filed and docketed as ASBCA No. 46409.

FINDINGS OF FACT

Contracts in Issue

1. The contracting officer's decision which generated these appeals (R4, tab 58) states that the Government's monetary claim relates to all firm fixed-price contracts containing the CAS clause, entered into by E-Systems prior to 10 December 1984 and performed in whole or in part after 1 January 1985. The decision states further that "the

administrative effort that would be required to review each contract and subcontract negotiated during [the above] time-frame would not be cost beneficial to the Government or to E-Systems.” Accordingly, rather than “attempting to determine the cost impact [of the alleged change in cost accounting practice] by contract/subcontract,” the amount of the claim is based on total sales under firm, fixed-price contracts for the period during which the impact is said to have occurred.

2. The contract cited in the caption of this appeal is a basic ordering agreement (BOA). Order 0007 under the BOA is identified in the contracting officer’s decision as “[t]he contractual vehicle selected for the purpose of issuing this final decision/demand letter.” As stated in the decision, Order 0007 was issued with an effective date of 1 October 1984, was physically complete as of 22 October 1985, and had been closed out on 9 April 1987. The order consisted of firm, fixed-price and cost reimbursable line items. Contained in the BOA and incorporated into the terms of Order 0007 were the CAS clause and the ADMINISTRATION OF COST ACCOUNTING STANDARDS (APR 1984) clause, FAR 52.230-4.

The Dispute

3. Effective 1 January 1972, E-Systems established the “Salaried Retirement Plan” (hereinafter the “Plan”) which was a defined benefit pension plan designed to provide retirement and disability benefits to qualified salaried employees (tr. 2/131-32). FAR 31.205-6(j)(3), at all relevant times describes a “defined benefit pension plan” as one in which “the benefits to be paid or the basis for determining such benefits are established in advance and the contributions are intended to provide the stated benefits.” The CASB Disclosure Statement filed by E-Systems stated that the Plan “qualified under section 401(a) of the Internal Revenue Code of 1954, as amended” (R4, tab 8 at 21). Contributions to the Plan were accounted for as indirect costs and were allocated on that basis to contracts awarded to E-Systems by the Department of Defense (DoD).

4. Contributions to the Plan had been included in forward pricing rates for 1985 proposed by E-Systems to the Government on 25 September 1984. On 10 December 1984, E-Systems revised the proposed rates so as to delete the entire amounts of such contributions (R4, tab 14; tr. 2/136). The revised rates were agreed to by the contracting officer on 11 December 1984 (R4, tab 17; tr. 2/139). The deletion of pension contributions was based on advice to E-Systems that the actuarial valuation of the Plan for 1985 would exceed the actuarial accrued liability of the Plan by the amount of \$23,197,428 and that said excess was sufficient to fund the 1985 normal cost. As a result, no contribution to the Plan would be required during 1985.

5. The advice, given orally and subsequently confirmed in a letter dated 8 January 1985 (R4, tab 18) was rendered by Mr. Francis P. Noble, an actuary on the staff of A.S.

Hansen, Inc., the consultant to E-Systems on employee benefits and compensation matters. Mr. Noble had served as actuary for pension plans operated by E-Systems since the late 1970's.

6. In his testimony, Mr. Noble described "normal cost," as used in his advice, as being the "percentage of payroll . . . that if . . . paid . . . from each year from the date the employee became a participant [of the Plan], to the date [he] retired would fully fund his expected benefit" (tr. 3/15). "Normal cost" was defined in CAS 412.30, as of 1 January 1985, as the "annual cost attributable, under the actuarial cost method in use, to years subsequent to a particular valuation date." The term "actuarial accrued liability," is referred to as "actuarial liability" in CAS 412.30, as of 1 January 1985, and is there defined as follows:

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 administrative expenses over the present value of future contributions for the normal cost for all plan participants and beneficiaries.

7. The excess of actuarial liability over the value of the assets of a pension plan is referred to in CAS 412.30 (1 January 1985) as an "unfunded actuarial liability." The current CAS regulations describe the converse case, *i.e.*, the actuarial value of assets exceeds the actuarial liability, as an "actuarial surplus." 48 CFR § 9904.412-30(a)(2) (1999). In any year in which an actuarial surplus exists in an amount exceeding the normal costs for that year the plan is said to be "fully funded" (tr. 3/13). So far as the record shows, E-Systems was not aware of the fully funded status of the Plan prior to 10 December 1984.

8. Mr. Noble testified that as to any year, such as Year 1985 for the Plan, in which no contribution to a pension is required, the amount funded would be zero and, consequently, the amount of pension cost allocable to Government contracts would also be zero (tr. 3/16; ex. A-13). The Government agrees with that position, stating that "[t]he fully funded status of the Plan meant that E-Systems had [zero dollar] pension costs allocable to Government contracts with respect to contributions for 1985 because no such contributions were made" (Gov't post hearing br. at 12). The Government takes the same position with respect to 1986 in which the Plan, also, was in fully funded status with no contribution made by E-Systems. The prices of new contracts awarded in 1985 and 1986 did not include pension costs (Gov't post hearing br. at 47).

9. Mr. Noble's advice, in December, 1984, that the Plan was fully funded was based on actuarial valuation of the assets of the Plan using the Five Year Moving Market Value method. This was the valuation method for all Plan assets set forth in the CASB Disclosure Statement on file from E-Systems, as of 1 January 1985. The method is described, as follows, in Item No. 7.1.8 of Part VII ("Deferred Compensation and Insurance Costs") of the Disclosure Statement:

[T]he asset value is increased each year by contributions, investment income . . . and average annual market change in the five years ending on the valuation date. It is then decreased by benefit payments and expenses.

(R4, tab 8)

10. In February, 1986, Mr. Noble recommended to the trustees of the Plan that the method for valuation of assets be changed. He believed that the Five Year Moving Market Value method was no longer appropriate for valuation of real estate assets of the Plan. That method had been adopted in order to "smooth out" the effects of short term increases and decreases in the value of assets. Mr. Noble found that, rather than fluctuating, the value of real estate assets had steadily increased during the prior years. In these circumstances, use of the Five Year Moving Market Value method had caused the actuarial value of real estate to lag significantly behind the market value of such assets. With no need to smooth out variations in the value of real estate, it was appropriate to adopt current market value as the standard for valuation of real estate assets. The Five Year Moving Market Value method would continue to be used for the other assets of the Plan.

11. Mr. Noble recommended that the change in valuation method be made effective retroactively to 1 January 1985. By doing so, the formal actuarial report for the year 1985, to be issued in August, 1986, would reflect a full year of valuation of real estate at full market value and thereby provide "a better indication of what was going to happen in the future." (Tr. 3/25-27)

12. During February, 1986, the trustees of the Plan accepted the recommendations of Mr. Noble. The first document reflecting the change in valuation method was the formal actuarial report and certification of the Plan for the year 1985 which was submitted by Mr. Noble to the trustees and to E-Systems on 4 August 1986. Exhibit 2 ("Schedule of Amortizations for Plan Cost") of the report (R4, tab 22) showed an actuarial surplus totaling \$62,884,646 of which \$39,687,218 was due to the change in method of valuation of real estate. The portion of that surplus to be amortized, as a credit, in level annual amounts, over 30 years, was \$5,908,725. Of that amount, \$3,525,417 was attributable to the change in method of valuation of real estate. The

“Plan Reimbursable Expense Schedule” of the report showed a normal cost for 1985 (adjusted with interest) of \$17,290,670 reduced by the annual amortization of the actuarial surplus in the amount of \$5,908,725 for a net amount of \$11,381,945. However, based on the fully funded status of the Plan for 1985, the plan cost was shown as zero. (R4, tab 22 at 3)

13. The Plan was in fully funded status from 1 January 1985 until 1 January 1991 with no contributions required from E-Systems for any part of that period. Although the change to current market value for valuation of real estate assets became effective on 1 January 1985, the appreciation in value of real estate caused by that change was not needed for fully funded status until 1 January 1989 (ex. A-5). Prior to that date, for the period 1 January 1985 - 31 December 1988, the Plan would have been in fully funded status under the former valuation method, namely, on the basis of valuing all assets under the Five Year Moving Market Value method alone (tr. 3/29).

14. As of 1 January 1985, “cost accounting practice,” was defined in the CASB regulations, 4 C.F.R. § 331.20(k), in part as follows:

A “cost accounting practice” is any disclosed or established accounting method or technique which is used for measurement of cost, assignment of cost to cost accounting periods, or allocation of cost to cost objectives.

(1) Measurement of cost encompasses accounting methods and techniques used in defining the components of cost, determining the basis for cost measurement, and establishing criteria for use of alternative cost measurement techniques. . . . Examples of cost accounting practices which involve measurement of costs are:

(i) The use of either historical cost, market value, or present value.

15. The change in the valuation method, effective 1 January 1985, was not preceded, or immediately followed by, a conforming amendment of the E-Systems CASB Disclosure Statement. Indeed, the contracting officer did not learn of the change until sometime in 1988 when a copy of the actuarial report and certification for the Plan Year 1985 (finding 12) containing a description of the change was furnished to DCAA as part of the review of indirect cost accounts of E-Systems for its Fiscal Year 1985. (Tr. 1/139; R4, tab 27 at 2)

16. In a submittal dated 18 April 1989, subsequently modified on 15 September 1989 and 6 August 1990, E-Systems proposed various revisions of Part VII (“Deferred Compensation and Insurance Costs”) of its CASB Disclosure Statement. Each of these contained a modification of Item No. 7.1.8 to the effect that beginning with the 1985 plan year on 1 January 1985, the actuarial value of real estate assets of the Plan had been made equal to the market value. All other assets would continue to be valued pursuant to the Five Year Moving Market Value method. (R4, tab 32, apps. 26, 27; tab 37) DCAA thereafter reported that the above amendment “adequately describes” the change to the actuarial method of valuation of assets (R4, tab 33, app. 1 at 4). As of 18 March 1991, the contracting officer had concurred with all of the proposed revisions of the Disclosure Statement (tr. 1/29; R4, tab 43).

17. On 14 February 1989, DCAA transmitted to E-Systems a draft audit report characterizing the change in valuation method as a change in a cost accounting practice not promulgated in an amendment of disclosure statement and, as such, a breach of the CAS clause (R4, tab 27). Under ¶ (a) (2) of the CAS clause, E-Systems was obligated to:

Follow consistently [its] cost accounting practices in accumulating and reporting contract performance cost data concerning this contract. If any change in cost accounting practices is made for the purposes of any contract or subcontract subject to CASB requirements, the change must be applied prospectively to this contract, and the Disclosure Statement must be amended accordingly. If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) below, as appropriate.

At all relevant times, Part 401 (“Consistency in Estimating, Accumulating & Reporting Costs”) contained the following in § 401.40(b):

A contractor’s cost accounting practices used in accumulating and reporting actual costs for a contract shall be consistent with his practices used in estimating costs in pricing the related proposal.

18. Under ¶ (a)(3) of the CAS clause, E-Systems was obligated to “[c]omply with all CAS in effect on the date of award of this contract.” Para. (a)(5) of the clause required E-Systems to:

Agree to an adjustment of the contract price . . . if [E-Systems] or a subcontractor fails to comply with an applicable

Cost Accounting Standard or to follow any cost accounting practice consistently and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States together with interest thereon

19. As of 1 January 1985, the CASB regulations, at 4 C.F.R. § 331.70 (1985) (“Interpretation”), contained the following with respect to recovery of “increased costs paid by the United States” pursuant to ¶ (a)(5) of the CAS clause:

(a) Increased costs paid by the United States as referred to in the Cost Accounting Standards clause in § 331.50 shall be deemed to have resulted whenever the cost paid by the Government results from a change in a contractor’s cost accounting practices or from a failure to comply with applicable Cost Accounting Standards, and such cost is higher than it would have been had the practices not been changed or applicable Cost Accounting Standards been complied with.

(b) If the contractor under any fixed price contract, including a firm fixed price contract, fails during contract performance to follow his cost accounting practices or to comply with applicable Cost Accounting Standards, increased costs paid by the United States under contracts containing the clause set forth in § 331.50(a) is measured by the difference between the contract price agreed to and the contract price that would have been agreed to had the contractor proposed in accordance with the cost accounting practices used during contract performance. . . .

(c) The statutory requirement underlying this interpretation is that the United States not pay increased costs, including a profit enlarged beyond that in the contemplation of the parties to the contract when the contract costs, price, or profit is negotiated, by reason of a contractor’s failure to use applicable Cost Accounting Standards or to follow consistently his cost accounting practices. . . .

20. The DCAA draft audit report of 14 February 1989 suggested that there might be a “cost impact [from the change] on costs to complete for Government contracts that had been negotiated as of the date of the change” (R4, tab 27 at 2). On 11 January 1990,

DCAA issued a formal audit report affirming the position that nondisclosure of the change in valuation method was a breach of the CAS clause and recommending that E-Systems be assessed, under the provisions of ¶ (a)(5) of the CAS clause, for a cost impact plus accrued interest (R4, tab 33).

21. Previously, in a letter of 3 April 1989, E-Systems had noted that no contributions to the Plan had been made, or were even permissible, for the period in which the Plan was fully funded. Lacking such contributions, E-Systems contended that there could be no incurred pension costs for those years and, thus, no possible cost impact from the change in method of valuation. (R4, tab 29) DCAA did not agree that the fully funded status of the Plan precluded a cost impact from the change of the valuation method. In an audit report dated 15 February 1991 (R4, tab 42), DCAA asserted that as to the contracts negotiated with E-Systems prior to 10 December 1984 and performed, in whole or in part, after 1 January 1985 (hereinafter referred to as the “impacted contracts”), the change in valuation method of real estate assets of the Plan had caused an “overall annual reduction in pension costs” in the amount of \$3,525,417. That amount was obtained from Exhibit 2 (“Schedule of Amortizations for Plan Cost”) of the actuarial report for 1985.

22. Exhibit 2 showed an actuarial surplus of \$39,687,218 due to the change in method of valuation of real estate. The portion of that surplus to be amortized, as a credit, in level annual amounts, over 30 years, was \$3,525,417. (Finding 12) DCAA asserted that an annual reduction of pension costs in that amount would have been forecasted and negotiated in connection with forward pricing rates had the impacted contracts been priced on the basis of the changed valuation method (R4, tab 42 at 8).

23. Based on data in the annual reports of E-Systems for 1984 and 1985 showing a sales backlog of \$1,165,737,000, as of 31 December 1984 and 1985 sales of \$926,753,000, DCAA estimated that 1.25 years (“work-off period”) was required to complete the impacted contracts. Under that estimate all of the impacted contracts would have been completed by 31 March 1986. Proposed Finding of Fact No. 27, submitted by the Government prior to the hearing and admitted to by E-Systems, states that there were “Government contracts entered into prior to December 10, 1984 that were performed in 1985, 1986, 1987, 1988 and 1989” (Gov’t Proposed Finding of Fact No. 27; appellant’s response). However, except for Order 0007, which was completed in October, 1985 (finding 2), there is nothing in the record to show that any firm, fixed price contracts were being performed during the period 1985 - 1989 or that any amounts of pension costs included in the prices of those contracts were actually saved.

24. DCAA computed the total reduction of pension costs under the impacted contracts resulting from the change in valuation method by multiplying the annual amount of \$3,525,417 by the work-off period of 1.25 years, yielding the amount of \$4,406,771.

That amount was multiplied by 28 percent, the percentage of sales dollars generated in 1985 from firm, fixed-price contracts, to arrive at \$1,233,896 as the amount of reduction of pension cost under firm, fixed-price type impacted contracts that would have been obtained had the change in valuation method been known to the Government at the time of price negotiations. DCAA recommended that the contracting officer assert a claim against E-Systems in that amount, plus interest, for a total of \$2,013,110. (R4, tab 42)

25. The contracting officer accepted the analysis and recommendation set forth in DCAA's audit report dated 15 February 1991 (findings 22-24). On 30 November 1992, she issued a written decision pursuant to the Contract Disputes Act (CDA), 41 U.S.C. §§ 601-613, as amended, asserting a claim by the Government against E-Systems in the amount of \$1,233,896, plus interest, for the "difference between the estimated amounts negotiated for fixed price contracts for performance in 1985 and later and the price that would have been negotiated for fixed price contracts if the Government had known of the change in accounting practices at the time of negotiations" (R4, tab 56).

26. The decision was reissued on 11 December 1992 in order to correct a typographical error found in the previous text (R4, tab 58). A timely appeal from that decision was docketed as ASBCA No. 45771. On 6 January 1993, without admitting liability for the Government's claim, E-Systems paid the amount of \$1,837,736, comprised of the principal amount claimed plus agreed accrued interest (R4, tab 61). On 12 February 1993, E-Systems submitted a duly certified claim for repayment of that amount. The record does not indicate the actual date of receipt of the claim by the contracting officer. We find that in the ordinary course of the mails, it would have been received on 15 February 1993. An appeal based on the deemed denial of that claim was subsequently docketed as ASBCA No. 46409.

DECISION

These appeals relate to the Government's claim for savings of pension cost realized by E-Systems under DoD firm, fixed price contracts as the result of a change in the method of valuation of real estate assets held by the Plan. The Five Year Moving Market method was specified for valuation of those assets in the CASB Disclosure Statement on file from E-Systems as of 10 December 1984 (finding 9). Subsequently, E-Systems changed the valuation basis to current market value (findings 11, 12). The promulgation of the change in valuation method did not comply with ¶ (a)(2) of the CAS clause in that the Disclosure Statement was not amended, at that time, to show the change and, furthermore, said change was made effective, retroactively, as of 1 January 1985 rather than given prospective effect as provided in ¶ (a)(2) (findings 11, 12, 17).

The Government's position is that the revaluation of the real estate assets on the basis of current market value, without having complied with ¶ (a)(2), constituted

breaches of the requirements of ¶¶ (a)(2) and (a)(3) to follow consistently E-Systems' cost accounting practices, specifically, the Five Year Moving Market method for valuation of all assets, in accumulating and reporting contract performance cost data" and to "[c]omply with all CAS in effect on the date of award of this contract" (finding 18). In the latter regard, the revaluation of real estate assets was said to be a violation of the requirement of CAS 401 that the Five Year Moving Market method be used by E-Systems in accumulating and reporting actual costs for the contracts which had been negotiated and priced on that basis (finding 9).

The Government asserts, however, that "the only real issue [in this appeal] is whether these noncompliances resulted in the United States paying increased costs" (Gov't br. at 42) which is a prerequisite to recovery under ¶ (a)(5) of the CAS clause. The Government's rationale for recovery is that the prices of the firm, fixed price impacted contracts would have been lower had E-Systems used current market value rather than Five Year Moving Market value to determine the actuarial value of the real estate assets (Gov't br. at 43).

The response of E-Systems is grounded in the well established rule that the Government has the burden of proof with respect to a claim for a price adjustment under ¶ (a)(5) of the CAS clause. *Litton Systems, Inc., Guidance and Control System Division*, ASBCA No. 37131, 94-2 BCA ¶ 26,731 at 133,022. E-Systems contends that the Government has failed to show that "the Plan trustees' decision to adopt market value was the cause of any increased costs paid by the United States" (app. reply br. at 10). E-Systems asserts that the record affirmatively shows that entry of the Plan into fully funded status - not the change in valuation method - is what caused the saving of pension costs (app. reply br. at 2).

The parties have stipulated that the Government contracts entered into prior to 10 December 1984 were performed in 1985, 1986, 1987, 1988 and 1989 (finding 23). The plan was fully funded throughout that period with the result that E-Systems did not incur any of the pension costs which had been included in overhead rates used in negotiating those contracts (findings 13, 21). For the period 1 January 1985 - 31 December 1988, the fully funded status of the Plan and, thus, the pension cost savings, resulted from increases in value of the assets of the plan as measured by the Five Year Moving Market method (finding 13). Inasmuch as this was the cost accounting practice for valuation of assets that was in effect at the time of negotiation and award of the impacted contracts, any ensuing saving of pension cost could not have resulted from failures "to comply with an applicable Cost Accounting Standard or to follow any cost accounting practice" as required for recovery under ¶ (a)(5) of the CAS clause (finding 18).

The year 1989 was the first year in which the fully funded status of the Plan was caused by appreciation in value of real estate assets due to current market valuation of those assets (finding 13). Neither in the stipulation of the parties nor elsewhere in the record is there any indication that any firm, fixed-price contracts, which are the subjects of this claim, were being performed during 1989 or that any amounts of pension costs were actually saved in that year (finding 23).

The Government had the burden of proving that the change in the valuation method was the cause of savings of pension costs included in the estimated prices of impacted firm, fixed-price contracts. *See Astronautics Corp. of America*, ASBCA No. 49691, 99-1 BCA ¶ 30,390. It has failed to satisfy that burden and, accordingly, is not entitled to recover any portion of its claim.

CONCLUSION

On the basis set forth above, the appeals in ASBCA Nos. 45771 and 46409 are sustained in all respects. In addition, as to ASBCA No. 46409, E-Systems shall recover the amount of \$1,837,736, plus interest under § 12 of the CDA, 41 U.S.C. § 611, from 15 February 1993 (finding 26).

Dated: 16 June 2000

PENIEL MOED
Administrative Judge
Armed Services Board
of Contract Appeals

(Signatures continued)

I concur

RICHARD SHACKLEFORD
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

MARK N. STEMLER
Administrative Judge
Acting Chairman
Armed Services Board
of Contract Appeals

I concur

EUNICE W. THOMAS
Administrative Judge
Acting Vice Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA Nos. 45771 and 46409, Appeals of E-Systems, Inc., rendered in conformance with the Board's Charter.

Dated:

EDWARD S. ADAMKEWICZ
Recorder, Armed Services
Board of Contract Appeals