

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --)
)
Ball Corporation) ASBCA No. 49118
)
Under Contract No. F29601-86-C-0233)

APPEARANCES FOR THE APPELLANT: Thomas A. Lemmer, Esq.
Rebecca L. Crotty, Esq.
McKenna & Cuneo
Denver, CO

APPEARANCES FOR THE GOVERNMENT: Stephen R. Dooley, Esq.
Chief Trial Attorney
Jerome C. Brennan, Esq.
Regina Ann Schaffner, Esq.
Fadette Berthold, Esq.
JeanMarie Corbosiero, Esq.
Trial Attorneys
Defense Contract Management
District, Northeast (DLA)
Boston, MA

APPEARANCES FOR THE *AMICI CURIAE*: Terry L. Albertson, Esq.
Edward Jackson, Esq.
Crowell & Moring, LLP
Washington, DC

OPINION BY ADMINISTRATIVE JUDGE THOMAS

Appellant appeals from a contracting officer's decision claiming that its practice of measuring the cost of its employee stock ownership plan (ESOP) is noncompliant with Cost Accounting Standard 415 (CAS 415), "Accounting for the cost of deferred compensation." Appellant's ESOP is a leveraged ESOP. A trustee administers an employee stock ownership trust (ESOT) on behalf of the employees. The trustee borrowed funds for the purchase of convertible preferred stock for the trust. Appellant makes an annual cash contribution to the trustee which the trustee uses to make interest and principal payments on the debt. The Government contends that CAS 415-50(e)(1) (sometimes (e)(1)) prohibits measurement of that portion of the contribution which the trustee uses to make interest payments. Appellant argues that CAS 415-50(d)(6) (sometimes (d)(6)) is the controlling provision and that its practice is compliant with it.

The Government does not challenge allowability of the cost of the ESOP on grounds other than CAS noncompliance. The ESOP Association and others have filed an *amicus curiae* brief in support of appellant arguing that the costs are allowable under Federal Acquisition Regulation (FAR) 31.205-6(j)(8). We do not reach this argument. The parties presented expert and other testimony at a hearing. Only entitlement is to be decided. We sustain the appeal.

COST ACCOUNTING STANDARD 415

CAS 415, “Accounting for the cost of deferred compensation,” includes the following provisions:

9904.415-20 Purpose.

(a) The purpose of this Standard is to provide criteria for the measurement of the cost of deferred compensation and the assignment of such cost to cost accounting periods. . . .

. . . .

9904.415-30 Definitions.

(a)

(1) *Deferred compensation* means an award made by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods prior to the date of the receipt of compensation by the employee. . . .

. . . .

9904.415-40 Fundamental requirement.

. . . .

(b) The measurement of the amount of the cost of deferred compensation shall be the present value of the future benefits to be paid by the contractor.

. . . .

9904.415-50 Techniques for application.

....

(d) The following provisions are applicable for plans that meet the conditions of 9904.415-50(a) [concerning when a contractor is deemed to have incurred an obligation] and the compensation is to be paid in money.

....

(6) If the award is made under a plan which requires irrevocable funding for payment to the employee in a future cost accounting period together with all interest earned thereon, the amount assignable to the period of award shall be the amount irrevocably funded.

....

(e) The following provisions are applicable for plans that meet the conditions of 9904.415-50(a) and the compensation is received by the employee in other than money. The measurements set forth herein constitute the present value of future benefits for awards made in other than money and, therefore, shall be deemed to be a reasonable measure of the amount of the future payment:

(1) If the award is made in the stock of the contractor, the cost of deferred compensation for such awards shall be based on the market value of the stock on the measurement date; i.e., the first date the number of shares awarded is known.

48 CFR § 9904.415 (1994)

FINDINGS OF FACT

Effective 1 July 1989, appellant Ball Corporation established a leveraged ESOP as a component of its 401(k) plan. An ESOP is a defined contribution stock bonus plan (or combination stock bonus and money purchase plan) for employees which is designed to invest primarily in qualifying employer securities. A leveraged ESOP is a form of ESOP in which a trustee borrows the funds required to invest in qualifying employer securities.

The employer makes contributions to the ESOT which enable the trustee to make payments on the loan and release the securities for allocation to participating employees' accounts. The Internal Revenue Code (the Code) establishes criteria for ESOPs and provides tax benefits to encourage them. The parties have stipulated that appellant's ESOP meets the definition of an ESOP in the Code. (Ex. A-11 at 5; ex. B-1, ¶¶ 2, 3, 4; *see* 26 U.S.C.A. § 4975(e)(7) (West 1989))

Appellant entered into a trust agreement with Mellon Bank, N.A. (the trustee). The trustee borrowed \$70 million to purchase 1,904,762 shares of Ball Series B ESOP convertible preferred stock at \$36.75 per share. The stock is convertible into Ball common stock. Appellant contributed an additional 3,577 shares of the convertible preferred stock to the ESOT, one share for each participant in its 401(k) plan. In accordance with regulations under the Code, the trustee initially held the convertible preferred stock purchased with the \$70 million in a "Suspense Account." As the trustee paid and pays off the debt, shares are released from the Suspense Account to an "Allocated Share Account." The trustee also maintains accounts for participating employees. The trustee credits these accounts with "non-monetary units" representing the participants' interest in the shares in the Allocated Share Account. (Ex. B-1, ¶¶ 5, 7-9, 13, 15, 17; app. supp. R4, tab 45)

Semiannually, appellant contributes to the trustee the cash required to make interest and principal payments on the debt. The payments for the year are referred to as the annual cash contribution. These contributions are irrevocable. They consist of dividends at \$2.76 per share on the convertible preferred stock held by the ESOT and additional cash as needed for debt service. For example, in 1994, appellant contributed \$9,412,883 consisting of dividends of \$5,069,489 and other cash of \$4,343,394. Payments for interest and principal over the term of the loan will total \$120.8 million. In 1992 and 1993 appellant also contributed convertible preferred stock so that the quantity of shares held by the ESOT would be sufficient to administer the ESOP in accordance with its terms. Appellant also pays administrative expenses. The stock contributions and administrative expenses are not in issue in this appeal. (Exs. A-3, -7, B-1, ¶¶ 10, 11, 23)

As appellant explains the plan to its employees, each year it makes a matching contribution of convertible preferred stock on behalf of each participant in its 401(k) plan. The contribution equals 50 percent of the amount the participant contributes to the 401(k) (up to \$2,000), for a maximum contribution of \$1,000. If a participant does not contribute to the 401(k) plan in a particular year, his or her individual ESOT account is credited with a prorata share of the value of the dividends appellant has paid to the trustee on shares in the Allocated Share Account. Participants are entitled to direct the trustee how to vote the convertible preferred stock and to benefit upon retirement or other covered event from any appreciation in the value of the common stock into which the preferred stock is convertible. The ESOP establishes a minimal value for a share of

convertible preferred stock of \$36.75. Participants' accounts vest incrementally over five years. Participants receive the value of their account upon retirement or other covered event. The ESOP provides that "distributions from a [participant's] ESOP Account shall be made, in a lump sum, in either cash or in whole shares of common stock of the Company, as elected by the [participant]." In practice, 95% of the distributions which occurred during the years 1989-1994 were cash. (R4, tabs 97, 99, 105; app. supp. R4, tab 127 at 72-73, 87; ex. B-1, ¶¶ 14, 16)

Since 1 July 1989, appellant has measured, assigned and allocated ESOP costs as follows: (a) the measure of the cost is the monetary value of the annual contribution paid to the trustee, (b) the cost is assigned to the year when the irrevocable funding of the contribution occurs, and (c) the cost is allocated to segments pursuant to CAS 403. For tax purposes, appellant deducts the entire monetary value of its contributions to the ESOT. Appellant's financial reporting practices also result in its reporting approximately the entire amount of its contribution to the ESOT as an expense. (Ex. B-1, ¶¶ 18-22)

On 21 August 1995, the Corporate Administrative Contracting Officer (CACO) issued a decision that appellant's practice of measuring, allocating and accounting for its ESOP costs was not in compliance with CAS 415. The CACO determined that under CAS 415-50(e)(1), any amount exceeding the fair value of the convertible preferred stock (\$36.75 per share) was not allocable to government contracts. He demanded payment of \$6,244,141, the estimated amount of the cost impact on all CAS covered contracts for the years 1989 through 1994. (R4, tab 1)

On 28 August 1995, appellant filed a timely appeal. It alleged in its complaint that its accounting practices complied with CAS 415-50(d)(6) and that its ESOP costs were reasonable. It also included estoppel and retroactive disallowance arguments. At the hearing, appellant withdrew the latter counts of the complaint with prejudice, leaving for decision the merits of the CAS issue. (Tr. 3/162)

The parties have selected Contract No. F29601-86-C-0233 as a representative contract for purposes of the appeal. The Air Force awarded this contract to appellant on 28 February 1986 and it was ongoing as of 1989. It includes FAR 52.230-3, Cost Accounting Standards (APR 1984), and FAR 52.230-4, Administration of Cost Accounting Standards (APR 1984). (R4, tab 40)

The parties have stipulated that "[t]he government's claim against Ball based upon CAS § 415.50(e)(1) would render unallocable and, therefore, unallowable that portion of Ball's cost arising from its contribution to the trustee of Ball's ESOP (the 'Trustee') that the Trustee uses to pay the interest on the debt it incurred to purchase Ball's Series B ESOP convertible preferred stock" (ex. B-1, ¶ 90).

LEGISLATIVE AND ADMINISTRATIVE HISTORY

The Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, encouraged the formation of ESOPs “as a device for expanding the national capital base among employees—an effective merger of the roles of capitalist and worker.” *Donovan v. Cunningham*, 716 F.2d 1455, 1458, 1466 and nn. 23, 24 (5th Cir. 1983), *cert. den.*, 467 U.S. 1251 (1984). ERISA contemplated that employers would use ESOTs to obtain financing for the purchase of employer securities for the benefit of employees. To this end, ERISA “provided exemptions from portions of the ‘prohibited transaction’ rules of ERISA and the IRC [the Code] which otherwise would have stifled leveraged ESOP transactions.” (Ex. A-11 at 16)

On 11 July 1975, the Defense Contract Audit Agency (DCAA) issued Audit Guidance No. 115 addressing the allowability of contributions to an ESOT that the trustee of the ESOT uses to pay interest on debt incurred to purchase the employer’s stock. The Guidance concluded that:

We believe the Trust’s business transactions are independent of the contractor’s normal operations and cannot be commingled. . . . Interest paid and dividends received by the Trust should not be applied as a reduction of, or an offset against, allowable deferred compensation costs.

(App. supp. R4, tab 54, emphasis in original) Audit Guidance No. 115 remained in effect until 1982 when it was canceled as part of a revision of DCAA procedures which resulted in the cancellation of all outstanding audit guidance (tr. 2/207).

On 7 April 1976, the CAS Board (CASB) issued notice of proposed CAS 415. The proposed standard and related administrative history did not refer explicitly to ESOPs. (App. supp. R4, tab 57; ex. A-10, ¶ 44 at 70)

On 22 April 1976, DCAA recommended to the ASPR Committee that it consider revising ASPR 15-205.6(f)(1), concerning deferred compensation, “to make unallowable those stock bonus plan contributions used for the direct purchase of stock from the employer” (app. supp. R4, tab 56).

On 30 July 1976, the CASB issued CAS 415, effective 10 July 1977. Neither it nor related standard CAS 412, “Cost accounting standard for composition and measurement of pension cost,” which is applicable to deferred compensation paid for life, referred explicitly to ESOPs.

On 10 December 1976, in partial response to DCAA's recommendation, the ASPR Committee distributed an "ESOP Issue Paper" to other Government agencies and industry for comment. The Issue Paper included the issue of "ESOT Borrowing" and asked, "should the portion [of the contribution to the ESOT] applicable to the interest on the ESOT debt be considered unallowable under ASPR 15-205.17?" (App. supp. R4, tab 59 at DAR 01482, Case 76-76)

On 10 February 1977, the Executive Secretary of the CASB, the head of the CASB staff, responded to the ASPR Committee's issue paper. He stated that "the Employee Stock Ownership Plan is a deferred compensation plan within the meaning of Cost Accounting Standard 415." He continued:

Section 415(e)(1) provides: "If the award [deferred compensation] is made in the stock of the contractor, the cost of deferred compensation for such awards shall be based on the market value of the stock on the measurement date, i.e., the first date the number of shares awarded is known." In the case of an ESOP the measurement date is the date the trust fund buys the stock from the employer.

In summary, we believe that the allocable cost of an ESOP should be the amount paid to the trust fund to retire the obligation without interest and the cost should be assigned to the cost accounting period in which the payments to the trust fund are made.

(App. supp. R4, tab 60, brackets and emphasis in original)

On 23 September 1977, the ASPR Committee solicited comments on a proposed revision to ASPR 15-205.6(f). Proposed subparagraph (f)(2)(ii)(F)(b) would have provided that "when the ESOP trust borrowed money to purchase company stock, that portion of the contribution which would be required by the trust to pay interest charges is unallowable." (App. supp. R4, tab 66 at DLA 03057, Case 76-76)

Senator Long, Chairman of the Senate Finance Committee, the Executive Secretary of the CASB, and the Council of Defense and Space Industry Associations (CODSIA) all submitted comments opposing the revision. By letter dated 23 November 1977, Senator Long objected to the proposal with respect to interest, stating that "it negates the entire ESOP financing concept, which assumes that the annual employer contribution is sufficient to permit the ESOP to make the annual amortization on its loan." On 28 November 1977, the Executive Secretary of the CASB wrote on behalf of the CASB staff:

Proposed paragraph (F)(b) would make unallowable the portion of the payment to the ESOP trust which represents interest which must be paid by the trust. This paragraph conflicts with Standard 412 which . . . states that, for defined-contribution plans, a payment required to be made to the trust for a period shall be the cost for that period. Since, under an ESOP, the payment to the trust must include an interest element, the entire payment is an allocable cost. Without an interest payment by the trust, there could be no ESOP. Indeed, Standard 412 permits all expenses of a trust, including interest expense, to be included in computations of pension cost. Accordingly, we propose that paragraph (F)(b) be deleted

It should be noted that some ESOPs provide that participants may liquidate their accounts after a specified number years. In such a plan, the ESOP is deferred compensation within the definition set forth in Standard 415 rather than a pension plan as defined in Standard 412. However, the period during which an employee may liquidate his ESOP account has no bearing on the cost to be assigned to a given cost accounting period. Thus, the application of CAS 415 would yield the same allocable costs for a cost accounting period as would be determined under CAS 412.

On 5 December 1977, CODSIA urged that the proposal concerning interest be deleted. (App. supp. R4, tab 72 at 3; tabs 74, 75)

On 16 May 1978, the Acting Deputy Director, Defense Acquisition Regulatory System (DAR), successor to the ASPR, announced a new proposed cost principle applicable to ESOPs. The announcement stated that as a result of the comments received on the 23 September 1977 proposal “[I]t has been concluded that interest on money borrowed by an ESOP trust is a cost of the trust. Therefore, the interest disallowance has been deleted from the current coverage [relating to ESOPs].” (App. supp. R4, tab 89, case 76-76)

On 27 December 1982, DAC 76-41 revised DAR 15-205.6(f), to include coverage of ESOPs. The editorial comments stated that “[s]ubject to certain conditions, contributions to ESOPs are allowable” As revised, DAR 15-205.6(f)(2)(ii) stated that ESOPs “are considered pension plans.” (Ex. A-10, tab 16)

On 22 March 1983, DAC 76-43 “completely realigned” the compensation cost principle. It split former DAR 15-205.6(f) between new (j), Pension Costs, and (k), Deferred Compensation. It moved the ESOP provisions to DAR 15-205.6(j), Pension Costs, where they were included at (j)(7), and dropped the statement that ESOPs “are considered pension plans.” (Ex. A-10, tab 17 at 4)

On 20 December 1990, the Board decided *Ralph M. Parsons Co.*, ASBCA Nos. 37931 *et seq.*, 91-1 BCA ¶ 23,648, concerning a leveraged ESOP similar to appellant’s. The principal issue was whether the contractor’s 1984 contribution costs were reasonable and the Board so held. During the early stages of the dispute the parties had assumed that DAR 15-205.6(j)(7) was applicable to the costs. The Board stated in *Parsons* that it agreed with the parties’ current position that DAR 15-205.6(k) rather than DAR 15-205.6(j)(7) was applicable to the costs since the ESOP was not a pension plan (91-1 BCA at 118,459).

On 11 June 1991, the Director of Defense Procurement, Department of Defense issued a letter in response to a Congressional inquiry about Departmental policy with respect to reimbursement of contractor ESOP costs. The letter stated:

The Federal cost allowability regulations do not permit the reimbursement of contractor interest payments. However, in a leveraged ESOP, the plan trustee (as opposed to the contractor) borrows money to purchase a large block of company stock and then uses the contractor’s ESOP contributions to pay off that loan. The contractor’s allowable ESOP contributions are not limited by the principal or interest components of the ESOP trustee’s loan payments.

(App. supp. R4, tab 179 at 2, emphasis in original) The parties have stipulated that this letter “correctly states then current DOD policy.” The staff member who drafted the letter testified at a deposition that at the time he wrote the letter, he “thought all ESOPs were pension ESOPs.” (Ex. B-1, ¶¶ 77, 79 at 15)

On 1 April 1993, DCAA issued new “Audit Guidance on Allowability of Employee Stock Ownership Plan (ESOP) Costs.” This guidance instructed DCAA’s auditors that “[f]or leveraged ESOPs, costs assignable to a cost accounting period will be the fair market value of the stock on the date the contractor transfers the stock to the ESOP trust This measurement is based upon the provision in CAS 415.50(e)(1).” Mr. David Capitano, the Government’s expert in this appeal, who was transferred to DCAA headquarters in 1988, was responsible for drafting the guidance. He testified that the decision in the *Parsons* case led DCAA to revisit the subject of ESOPs, which it had

assumed were pension plans, and to issue the 1 April 1993 guidance. (App. supp. R4, tab 246 at 2; ex. G-1, ¶ 9; tr. 2/113, 115)

On 23 November 1994, the Deputy Director of Defense Procurement (Cost, Pricing and Finance), Department of Defense wrote the CASB suggesting that it clarify CAS 412 and 415 with respect to ESOPs. The Deputy Director said that “[s]ince both standards are silent regarding the treatment of contributions to leveraged plans, some defense contractors argue that, under both standards, principal and interest payments made to a leveraged defined contribution plan constitute employee compensation.” The parties have stipulated that the CASB did not adopt this suggestion or other requests for clarification. (App. supp. R4, tab 305 at DLA 03282; ex. B-1, ¶¶86, 87, 88 at 17))

On 7 November 1995, after this appeal was filed, the FAR Council proposed changes to the cost principles addressing ESOPs. The Federal Register announcement said that “[t]he purpose is to ensure uniform treatment on the allowability of costs of all ESOP’s irrespective of whether the ESOP is structured as a pension plan or as deferred compensation, including making the interest costs of leveraged ESOPs expressly unallowable.” The proposed change would have removed FAR 31.205-6(j)(8), formerly DAR 15-205.6(j)(7), and added new FAR 31.205-6(p), Employee stock ownership plans (ESOPs). Paragraph 31.205-6(p)(5) would have stated: “Contractor contributions to an ESOT are unallowable to the extent they are used by the ESOT to pay interest on borrowings, however represented.” (App. supp. R4, tab 314, 60 Fed. Reg. 56216, Case 92-24)

Numerous members of Congress and the public commented upon the proposed change. The consistent criticism within these comments was that the proposed rule would render unallowable a portion of a contractor’s cost arising from contributions to an ESOT made pursuant to the terms of a leveraged ESOP, thereby undermining existing leveraged ESOPs and disincentivizing the future use of leveraged ESOPs by Government contractors. The FAR Council withdrew the proposed rule on 3 April 1996, stating that “the respondents expressed concerns that the rule, as currently written, would (1) inhibit the establishment of new ESOPs and the expansion of existing ESOPs by Government contractors, and (2) adversely impact the financial condition of Government contractors with existing ESOPs.” (Ex. B-1, ¶¶ 84, 85)

The National Defense Authorization Act for Fiscal Year 1998, Public Law 105-85, signed into law on 18 November 1997, includes Section 844, Sense of Congress Regarding Allowability of Costs of Employee Stock Ownership Plans, which states:

It is the sense of Congress that the Secretary of Defense should not disallow, under Department of Defense contracts, the following costs:

(1) Interest costs associated with deferred compensation employee stock ownership plans that were incurred before January 1, 1994.

(2) Costs related to employee stock ownership plan (ESOP) debt, control premiums, or marketability discounts associated with the valuation of ESOP stock of closely held companies that were incurred before January 1, 1995.

(App. supp. citation of authority, ex. A)

EXPERT TESTIMONY

Each party called an accounting expert to testify on its behalf. The Government called Mr. Capitano. Appellant called Mr. William T. Keevan. The Board found their testimony helpful.

Mr. Capitano is a procurement analyst in the Office of the Secretary of Defense, Acquisition and Technology, Director Defense Procurement (Cost, Pricing, and Finance). In addition to being a certified public accountant and member of the American Institute of Certified Public Accountants (AICPA), Mr. Capitano holds a Master of Business Administration from George Mason University. Mr. Capitano began his professional career as an auditor with DCAA in 1979 and has worked continuously for the Department of Defense since that time. From 1988 to 1996 except for a period of time when he was on special assignment he was assigned to the Accounting Policy Division at DCAA Headquarters. He was responsible for issues relating to deferred compensation including ESOPs. At the Office of the Secretary of Defense, he is the senior specialist and advisor on CAS and related contract cost issues. (Ex. G-1, ¶¶ 1-4, 6, 7, 9)

Mr. Keevan is the Managing Director of Government Contract Consulting Services and an audit partner for Arthur Andersen LLP, resident in the Washington office. He is a certified public accountant and member of the AICPA. He served for six years on the AICPA Defense Contractors Committee including three years as Chairman. He holds or has held positions with a variety of other professional organizations. (Ex. A-10 at 1 and at tab 1)

Mr. Capitano considers that CAS 415-50(e)(1) is the controlling provision for purposes of this appeal. CAS 415-30(a)(1) defines deferred compensation as “an award made by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods prior to the date of the receipt of compensation by the employee.” CAS 415-50(d) is applicable when “the compensation is to be paid in money” and CAS 415-50(e) is applicable when “the compensation is received by the employee in other than money.” Mr. Capitano believes “that the benefits that the employee receives are in the form of stock. And that is because the employee has the ability to vote stock, has the ability to receive dividends, and has a right to a share in the appreciation of the stock.” He does not believe that it would be reasonable to have the measurement of the award turn on whether the employee in fact elects a distribution of cash or stock. Once it is determined that CAS 415-50(e) is applicable, then (e)(1) requires that the cost of the compensation be based on the market value of the stock (here, \$36.75). (Tr. 2/100-01, 174-76; ex. G-1, ¶ 24 at 8)

If one assumes that appellant is correct that CAS 415-50(d)(6) is applicable, Mr. Capitano still arrives at the same result. He points to the fundamental requirement in CAS 415-40(b) that “[t]he measurement of the amount of the cost of deferred compensation shall be the present value of the future benefits to be paid by the contractor.” Mr. Capitano states that “present value requires taking the future value and bringing it back to today’s value.” CAS 415-50(d)(6) provides that:

(6) If the award is made under a plan which requires irrevocable funding for payment to the employee in a future cost accounting period together with all interest earned thereon, the amount assignable to the period of award shall be the amount irrevocably funded.

Reading this provision in light of the fundamental requirement, Mr. Capitano states that only the portion of the irrevocable funding which is to be paid to the employee should be measured for assignment to government contracts. He testified that (d)(6) “is measuring what portion of that funding is for payment to the employee in the future cost accounting period.” (Tr. 2/155, 188, *see also* 2/205)

Mr. Capitano agrees with appellant that the annual cash contribution represents deferred compensation. He also agrees that if CAS 412 relating to pensions were applicable, the entire amount of the contribution would be allocable and allowable. (Tr. 2/136, 139-40, 208)

Mr. Keevan considers that CAS 415-50(d)(6) is the controlling provision for purposes of this appeal. He states that “neither CAS 415.50(d)(6) nor CAS 415.50(e)(1) is a ‘perfect fit’ with Ball’s leveraged ESOP.” He explains that:

. . . CAS 415 distinguishes between two types of plans: (1) plans where “the compensation is to be paid in money,” which are addressed by CAS 415.50(d); and (2) plans where “the compensation is received by the employee in other than money,” which are addressed by CAS 415.50 (e).

Unfortunately, the distinction in CAS 415 between these two types of plans is ill-suited to leveraged ESOPs like Ball’s. Under Ball’s leveraged ESOP, which is typical of such plans: (1) Ball semi-annually makes irrevocable contributions to the ESOT in cash, with occasional supplemental contributions in stock, to permit the ESOT to meet its obligations under the ESOP; (2) the ESOT, acting as a fiduciary for the participating employees, uses the cash contributed by Ball to pay the principal and interest on the ESOT’s borrowings, thereby allowing for the allocation to employee accounts of shares of a special series of preferred stock; and (3) at retirement or other qualifying event, the employees ultimately receive under the ESOP cash or common stock (*not* the preferred stock held by the ESOT) in a value equal to the then-current value of their ESOP accounts. Ball’s ESOP cannot neatly be categorized for purposes of determining whether CAS 415.50(d) or CAS 415.50(e) is the applicable provision because Ball’s contribution to the plan can be paid in both money and stock and Ball’s participating employees can ultimately receive their deferred compensation in either money or stock.

(Ex. A-10, ¶ 43 at 68, ¶ 44 at 69-70)

In Mr. Keevan’s opinion, although neither provision is a perfect fit, CAS 415-50(d)(6) “is the FAR better fit and should be applied to measure and assign the costs of Ball’s ESOP” (ex. A-10, ¶43 at 68, capitalization in original). He states that:

Given that both the contributions to the ESOT by Ball and the payments by the ESOT to withdrawing members are made overwhelmingly in the form of cash, in my opinion, the compensation under Ball’s ESOP “is to be paid in money” for purposes of CAS 415.50(d).

Second, in my opinion, it is particularly significant that CAS 415.50(d)(6) specifically addresses “a plan which requires irrevocable funding for payment to the employee in a future accounting period.” The express reference in CAS 415.50(d)(6) is important because “irrevocable funding” is an essential element of Ball’s ESOP. In contrast, no provision in CAS 415.50(e) specifically addresses “irrevocable funding.” CAS 415.50(e)(1) addresses awards made in the stock of the contractor, but neither it nor any other provision of CAS 415.50(e) even alludes to plans providing for payments in money, let alone to irrevocable funding. In my opinion, therefore, CAS 415.50(d)(6) is the only provision that can reasonably be viewed as specifying an accounting treatment applicable to Ball’s ESOP.

(Ex. A-10, ¶ 45 at 71)

Mr. Keevan supports his opinion with four additional rationales. First, the Government’s method, which would fail to measure the cost of that portion of the annual cash contribution which exceeds the value of the shares that the ESOT allocates to participating employee accounts, conflicts with the cost accounting concept in the preamble to CAS 415 ““that *all* costs incurred in carrying on the activities of an enterprise are allocable to the cost objectives of the enterprise.”” Second, the Government’s method is inconsistent with the administrative history relating to the allowability of ESOT costs set forth above. Third, the Government’s method “would directly conflict with the national policy of encouraging the use of leveraged ESOPs.” Fourth, the cost of the ESOP should be measured by the amount of the irrevocable contributions to the ESOT to ensure consistency with CAS 412. (Ex. A-10, ¶ 34 at 51-53)

Mr. Keevan disagrees with Mr. Capitano’s interpretation that the fundamental requirement in CAS 415-40(b) relating to present value means that only a portion of the irrevocable funding should be measured for purposes of government contracts. Thus, Mr. Keevan testified on cross examination:

Q Well, do you agree that . . . the fundamental requirement is that deferred compensation is to be measured by the present value of future benefits received by the employees?

....

A Yes, I agree with that.

Q Okay. Then construing [CAS 415-40(b)] to mean that, wouldn't that basically limit [(d)(6)] to irrevocable funding going to the employee?

A No, I don't think so because the fundamental problem is the contractor's cost of providing whatever benefits the employee gets is what is irrevocably funded and that is the present value of providing those benefits. That is the contractor's cost.

....

Q So the way you would construe these provisions the present value of the 70 million in stock to be paid to the employees, be it in stock or cash, is 120.8 million because that's what the irrevocable funding is?

A The irrevocable funding is the contractor's cost and it provides whatever benefits, it is a present value. I give up the cash today, I have no further use of it. The contractor has no further use of the cash. That is the present value of the benefits that are derived by the employees from the ESOP. And that measures the contractor's cost.

(Tr. 3/146-48, *see also* 3/153-54)

DECISION

The Government claims that appellant's practice of measuring the cost of its ESOP, specifically the cost of the annual cash contribution, is noncompliant with CAS 415-50(e)(1). Appellant argues that CAS 415-50(d)(6) is the controlling provision and that its practice is compliant with it. The Government responds that appellant's practice is noncompliant with that provision as well. (App. br. at 26; Gov't br. at 8-9)

“In any appeal that involves alleged noncompliance with cost accounting standards, the burden is on the Government to establish the noncompliance.” *Unisys Corp.*, ASBCA No. 41135, 94-2 BCA ¶ 26,894 at 133,900. *Accord Litton Systems, Inc., Guidance and Control System Division*, ASBCA No. 37131, 94-2 BCA ¶ 26,731 at 133,022. The cost accounting standards are regulations whose interpretation is a question of law. Our task in interpreting the standards “is ultimately to ascertain the CASB's intended meaning when it promulgated the CAS.” *Perry v. Martin Marietta Corp.*, 47 F.3d 1134, 1137 (Fed. Cir. 1995).

The parties agree that CAS 415 is applicable to the measurement of the cost of appellant's ESOP (app. br. at 26; Gov't br. at 8). CAS 415-40(b) states the fundamental requirement that "[t]he measurement of the amount of the cost of deferred compensation shall be the present value of the future benefits to be paid by the contractor." CAS 415-50 sets forth various techniques for application. It distinguishes between plans in which "the compensation is to be paid in money" (CAS 415-50(d)) and plans in which "the compensation is received by the employee in other than money" (CAS 415-50(e)). Paragraph (d)(6) provides:

(6) If the award is made under a plan which requires irrevocable funding for payment to the employee in a future cost accounting period together with all interest earned thereon, the amount assignable to the period of award shall be the amount irrevocably funded.

Paragraph (e)(1) provides:

(1) If the award is made in the stock of the contractor, the cost of deferred compensation for such awards shall be based on the market value of the stock on the measurement date; i.e., the first date the number of shares awarded is known.

The first issue is whether the Government has established that appellant's practice of measuring the cost of the annual cash contribution is noncompliant with CAS 415-50(e)(1). CAS 415-50(d) and (e) focus in the introductory paragraphs on the form of the deferred compensation at the time the employee receives the benefits, in appellant's case, upon retirement or other covered event. The drafters of the standard apparently intended to draw a bright line between two types of plans, those involving the distribution of money and those involving the distribution of assets other than money. As pointed out by appellant's expert, however, appellant's ESOP involves both types of distribution. The Government has not persuaded us that the compensation should be considered to be received by the employees in "other than money" (*i.e.*, stock) because, prior to distribution, the employees have certain rights which are analogous to those of stock ownership. We conclude, therefore, that the Government has not established that CAS 415-50(e) and, specifically, the technique at (e)(1), are applicable to the measurement of the cost of the annual cash contribution.

The second issue is whether CAS 415-50(d)(6) is the controlling provision and, if so, the Government has established that appellant's practice of measuring the cost of the annual cash contribution is noncompliant with it. The parties agree that appellant's

annual cash contribution “is made under a plan which requires irrevocable funding.” The Government argues, however, that only the amount used for payment of principal is irrevocably funded “for payment to the employee in a future cost accounting period together with all interest earned thereon.” Appellant argues that the entire amount is irrevocably funded for payment to the employee since the entire amount must be funded in order for payment to occur. It states, “[a]bsent Ball contributing the required amount of cash each year to the Trustee, the Trustee would be unable to meet these costs; the Trust would fail; and Members would receive nothing.” (App. br. at 34)

As noted above, neither CAS 415-50(d) or (e) is applicable by its terms to appellant’s ESOP because the compensation may be received by the employee in either money or “other than money” rather than in one or the other. Similarly, (d)(6) is not applicable by its terms to appellant’s ESOP because it is not “a plan which requires irrevocable funding for payment to the employee in a future cost accounting period together with all interest earned thereon.” Neither party has persuaded us, therefore, that its position with respect to (d)(6) is entirely correct.

We turn for guidance in this circumstance to the fundamental requirement in CAS 415-40(b). That provision states that “[t]he measurement of the amount of the cost of deferred compensation shall be the present value of the future benefits to be paid by the contractor.” We conclude that the Government has not shown that the present value of the future benefits in a leveraged ESOP with a mix of payout options may not reasonably be measured through the irrevocable payments made by appellant to the trustee. We reach this conclusion for the following reasons.

First, each party offered expert testimony about whether appellant’s practice conformed to the fundamental requirement. We are unable to conclude that the Government’s evidence was more persuasive than the appellant’s. Second, under the Government’s interpretation, CAS 415 fails to measure, and, ultimately, allocate, a portion of the amount which is funded. Third, in construing a cost accounting standard, we normally look, to the extent there is ambiguity, to the administrative history and any CASB interpretations for guidance. *Honeywell, Inc. v. United States*, 661 F.2d 182, 186 (Ct. Cl. 1981). The only administrative history and interpretations which the parties have identified are the Executive Secretary’s 10 February 1977 and 28 November 1977 letters. There is no indication in the record that the CASB as opposed to the Executive Secretary approved the letters and they are not, therefore, entitled to much weight. As between them, however, we attach more weight to the 28 November 1977 letter, which indicated that the entire payment to the trustee should be allocable, as the later statement of the staff’s position. Fourth, there is overwhelming evidence that at or about the time CAS 415 was issued, the ASPR Committee and DCAA were concerned about contractor payments to ESOTs, in part because of the use of the payments for interest, and that they, as well as the Chairman of the Senate Finance Committee and industry, believed that a

revision to the cost principles was needed to render them unallowable. We look to this history “not as a controlling interpretation but rather as valuable evidence of the thinking of knowledgeable persons both in Government and in industry as to a reasonable construction of” the applicable regulations. *Bell Helicopter Textron*, ASBCA No. 21192, 85-3 BCA ¶ 18,415 at 92,420. When those individuals attempted to revise the cost principles to disallow that portion of the contributions to ESOTs used for interest payments, they were forced to abandon the attempt by Congressional and industry opposition. We recognize, of course, that they were concerned with allowability as opposed to allocability. These proposals would not have been necessary, however, if the costs were not allocable. Furthermore, although the record is not quite so clear, the same scenario repeated itself in 1995-1996. *Cf. Gulf Life Insurance Co. v. United States*, 118 F.3d 1563, 1566 (Fed. Cir. 1997) (“a clearly stated legislative purpose to revise the law is informative when considering the argument that the prior law should be interpreted to be identical to the later revision”). We find unconvincing, in light of the documents from 1975 through 1978, the Government’s explanation for this history in its brief that “DoD’s guidance prior to the early 1990s was based on an assumption that all ESOPs were pensions, which precluded any consideration of the application of CAS 415 measurement provisions to ESOPs” (Gov’t br. at 43).

We conclude, therefore, that the Government has not established that appellant’s practice of measuring the annual cost of its ESOP is noncompliant with CAS 415.

CONCLUSION

The appeal is sustained.

Dated: 3 April 2000

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

I concur

I concur

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

JACK DELMAN
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 No. 49118, Appeal of Ball Corporation, rendered in conformance with the Board's Charter.

Dated:

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