

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --)
)
Raytheon Company) ASBCA Nos. 57576, 57679
)
Under Contract Nos. N00019-06-C-0310)
FA8807-06-C-0004)

APPEARANCES FOR THE APPELLANT: Paul E. Pompeo, Esq.
C. Scott Morrow, Esq.
William S. Speros, Esq.
Lauren J. Schlanger, Esq.
Arnold & Porter LLP
Washington, DC

APPEARANCES FOR THE GOVERNMENT: E. Michael Chiapas, Esq.
DCMA Chief Trial Attorney
Stephen R. Dooley, Esq.
Senior Trial Attorney
Kathleen P. Malone, Esq.
Alexander M. Healy, Esq.
Trial Attorneys
Defense Contract Management Agency
Boston, MA

OPINION BY ADMINISTRATIVE JUDGE DELMAN ON APPELLANT'S MOTION
FOR DECLARATORY JUDGMENT

Under these appeals Raytheon Company (Raytheon or appellant) challenges the government's assertion of claims to recover increased costs paid under government contracts, plus penalties and interest, resulting from CAS and FAR violations.¹ Under ASBCA Nos. 57576 and 57679, Raytheon has moved for declaratory judgment, seeking the dismissal of these appeals on the ground that the government's claims are untimely.² The government opposes the motion, contending that its claims are timely.

¹ The government's claims relate to the activities and practices of Raytheon's corporate home office.

² Appellant's motion does not pertain to its appeal under ASBCA No. 58290, which was filed by notice of appeal dated 20 August 2012 from a contracting officer's decision asserting a government monetary claim dated 25 May 2012.

STATEMENT OF FACTS (SOF) FOR PURPOSES OF THE MOTION

ASBCA No. 57576 –Alleged Unallowable Incentive Compensation Cost for Persons Performing Expressly Unallowable Activity and Penalty

1. On 27 March 1991, Raytheon established a stock plan to govern the award of restricted stock units to company employees as an element of their compensation (app. mot., ex. 2). On 30 November 1992, Raytheon and the government executed an “Advance Agreement on the Allowability of Costs of Raytheon Company Restricted Stock Awards” (Advance Agreement) (ASBCA No. 57576 (57576), app. supp. R4, tab 201). Under the terms of the Advance Agreement the government agreed to “recognize as allowable cost[s] the restricted stock awards made in 1991 and subsequent awards made from the Plan from time to time” (*id.* at 2).

2. On 6 March 2000, Raytheon provided a briefing to the Defense Contract Audit Agency (DCAA) on Raytheon’s “Total Compensation Program,” which discussed the company’s different bonus compensation plans, including the results based incentive (RBI) program, the performance-sharing (PS) plan and the long-term achievement program (LTAP) (app. mot., ex. 4). Raytheon revised these plans over time, and DCAA had occasion to review the revisions.

3. For example, by memorandum dated 14 December 2000, DCAA reviewed certain revisions/enhancements to the existing RBI/PS bonus incentive plans for calendar year (CY) 2000.³ DCAA stated, *inter alia*, that “we are unable to comment on the overall reasonableness of the compensation levels” (app. mot., ex. 7 at 2). By audit report dated 27 September 2002, DCAA advised appellant, as part of the CY 2000 incurred cost audit, “that based on our evaluation and analysis, we take no exception to the RBI/PS [e]nhancements to the [Raytheon business] segments” (app. mot., ex. 8 at 6).

4. Effective 1 February 2001, Raytheon established a stock plan the purpose of which was “to encourage ownership of Stock by key employees...and to provide additional incentive for them to promote the success of the Company’s business” (57576, app. supp. R4, tab 202, Article II, ¶ 2).

5. While it appears that the parties terminated the 1992 Advance Agreement, Raytheon and the government executed a memorandum of understanding in April 2002 regarding the allocation methodology for Raytheon’s 1991 and 2001 stock plans, continuing the allocation methodology under the 1992 Advance Agreement (57576, app. supp. R4, tab 203).

³ Raytheon used the calendar year as its fiscal year. See Disclosure Statement dated 21 January 2003, Item No. 1.7.0 (app. mot., ex. 9 at I-2).

6. In or around June 2003, Raytheon forwarded its CY 2002 “overhead cost submission” to the government. This submission appears to list bonus and related incentive compensation costs among Raytheon’s incurred costs for CY 2002. (57576, app. supp. R4, tab 204)

7. On 29 September 2003, DCAA issued a memorandum related to its audit of Raytheon’s bonus costs for CY 2002 (app. mot., ex. 10). DCAA stated that “[b]ased on our examination, we take no exception to claimed costs of...Results Based Incentive (RBI) and Performance Sharing (PS) bonus programs. In addition, we take no exception to claimed costs...proposed for Other Incentive Awards.” (*Id.* at 1) The audit memorandum stated that DCAA “examined and verified that the corporate office met the criteria set forth in the CY 2002 RBI and PS bonus plans” and that “[t]he costs are determined to be allowable per FAR 31.205-6(f), Bonuses and incentive compensation” (*id.* at 2).

8. In or around June 2004, Raytheon forwarded its CY 2003 “overhead cost submission” to the government. This submission also appeared to list bonus and restricted stock award costs paid to corporate employees among Raytheon’s incurred costs for CY 2003. (57576, app. supp. R4, tab 206) On 28 February 2005, DCAA issued an audit report of Raytheon’s 2003 overhead cost submission (app. mot., ex. 12). DCAA concluded that, except for the specific objections noted in the audit report not directly pertinent here, “the contractor’s proposed indirect costs are acceptable as adjusted by our examination” (*id.* at 5). Raytheon’s overhead cost submission for CY 2004 was submitted to the government on 2 June 2005 (opp’n at 53 ¶ 9).

9. As required by law, Raytheon periodically furnished a CAS Disclosure Statement (DS) to the government, which contained a written description of Raytheon’s cost accounting practices and procedures. For example, a DS was submitted to the government on around 21 January 2003. This DS identified bonus and restricted stock plan costs as part of home office expenses. (App. mot., ex. 9 at VIII-19, -23)

10. Raytheon also periodically submitted to the government “forward pricing rate brochures” (FPRBs). On 4 May 2004 Raytheon submitted a FPRB to the government for 2004-2008, updated on 22 September 2004 (app. supp. R4, tabs 205, 208). At the request of the government the DCAA “examined Raytheon Company’s September 22, 2004 Corporate Home Office Allocations proposal for forward pricing costs and rates to determine if the proposed forward pricing costs and rates are reasonable” (app. mot., ex. 11 at GOV018010). On 7 January 2005, DCAA issued an audit report and concluded, among other things, that “we consider the [FPRB] proposal to be a basis for negotiation of a fair and reasonable price” (*id.* at GOV018011).

11. By email dated 30 November 2006, the DCAA informed Raytheon “that Bonus and Restricted Stock awards are compensation/fringe type costs and that these

type of costs...should be proportionately withdrawn along with unallowable labor” (57576, R4, tab 3). Raytheon did not agree. On 24 September 2007, DCAA issued an audit report relating to CYs 2002-2005 that stated that appellant’s failure to withdraw from its incurred cost submissions a proportionate share of its costs of bonuses, restricted stock and other incentive compensation costs paid to employees engaged in expressly unallowable activities was a violation of FAR 31.201-6(a) and CAS 405-40(a) (57576, R4, tab 8 at 2). Raytheon contested the government’s position.

12. On 30 May 2008, the government issued to appellant an initial determination of noncompliance (IDN) on this matter for CYs 2002-2005 (57576, R4, tab 11). A later DCAA audit report dated 10 June 2008 included CY 2006 costs (*id.*, tab 12). The government revised its IDN on 27 June 2008 to include questioned CY 2006 costs (*id.*, tab 13).

13. On 14 May 2010, the government issued a final determination of noncompliance (FDN) on this matter for CYs 2002-2008, and demanded a general dollar magnitude impact report from appellant (57576, R4, tab 15). Raytheon submitted impact reports under protest (*id.*, tabs 17, 18), and also updated these reports to include CY 2009 impact (*id.*, tab 19).

14. By letter to Raytheon dated 10 January 2011, the contracting officer (CO) issued a final decision. Pursuant to the contract clause, FAR 52.230-2, COST ACCOUNTING STANDARDS (APR 1998), the CO demanded payment of \$14,065,816, including interest, as a price adjustment for increased costs paid by the government on Raytheon’s fixed price and flexibly priced contracts and subcontracts as a result of its noncompliance with CAS 405 for CYs 2002-2009. The CO identified Contract No. N00019-06-C-0310, a CAS-covered firm fixed price contract⁴ awarded to Raytheon in December, 2005, and Contract No. FA8807-06-C-0004, a flexibly price contract awarded to Raytheon in May, 2006, as representative contracts that incurred these increased costs, both of which contained the subject CAS clause (R4, tab 1 at G-000003; R4, tab 2 at G-000008). (57576, R4, tab 20)

15. The CO also issued a penalty against Raytheon due to its inclusion of expressly unallowable costs in its final indirect cost rate proposals for CYs 2002-2009, in the amount of \$5,946,762, including interest, pursuant to the contract clause FAR 52.242-3, PENALTIES FOR UNALLOWABLE COSTS (MAY 2001) (the Penalties clause), which clause was also contained in the representative contracts (R4, tab 1 at G-000003; R4, tab 2 at G-000009). The CO’s final decision demanded the total sum of \$20,012,578. (57576, R4, tab 20)

⁴ This contract included cost plus fixed fee line items. Both representative contracts also contained the clause FAR 52.216-7, ALLOWABLE COST AND PAYMENT (DEC 2002) (Allowable Cost clause) (R4, tab 1 at G-000002; R4, tab 2 at G-000007).

16. Appellant timely appealed the CO's decision to this Board, and the appeal was docketed as ASBCA No. 57576.

ASBCA No. 57679 – Alleged Unallowable Costs and Penalty – Total Shareholder Return (TSR) Metric

17. In January 2004, Raytheon briefed the government on changes to its long-term incentive plans (app. mot., ex. 14). Raytheon advised that it had decided to replace its LTAP with the "long-term performance plan" (LTPP) (*id.* at 6). Raytheon's presentation explained, among other things, key aspects of the LTPP, including that the number of shares earned and awarded to LTPP participants would depend on meeting TSR and free cash flow (FCF) metrics established in a three-year performance cycle (*id.* at 8).

18. On 19 July 2004, DCAA issued an audit report on Raytheon's long-term incentive compensation plans, restricted stock plan and LTPP (app. mot., ex. 16). In this audit report DCAA examined, *inter alia*, the internal control procedures associated with these plans to ensure they were compliant with applicable laws and regulations, including the FAR and CAS (*id.* at 1). The DCAA audit report concluded that "the Long-Term Incentive Plan compensation system and related internal control policies and procedures of the contractor are adequate" (*id.* at 2).

19. The government's opposition to appellant's motion, insofar as pertinent, states as follows:

The Government does not deny that, as part of DCAA's 2004 assessment of the viability of Raytheon's newly implemented LTPP, it did not question the validity of the TSR metric. Furthermore, the Government does not deny that, as part of this review, DCAA had access to information concerning the TSR metric.

(Gov't opp'n at 55)

20. On 23 August 2004, DCAA issued a report in which the government examined Raytheon's corporate home office allocation forecast for CYs 2004-2008 (app. mot., ex. 18). DCAA stated that "we consider the forecast to be acceptable as a basis for negotiation of forward pricing rates" (*id.* at 2). On 7 January 2005, DCAA issued an audit report relating to its audit of Raytheon's 22 September 2004 corporate home office allocations proposal for forward pricing costs and rates for CYs 2004-2008. DCAA stated that appellant's proposal was "acceptable for negotiation of a fair and reasonable price." (App. mot., ex. 11 at 1, 2)

21. Raytheon submitted its CY 2004 “overhead cost submission” in June, 2005 (57576, app. supp. R4, tab 210). Appellant’s motion papers concede that appellant did not include any LTPP costs in its overhead cost submission for CY 2004 or for CY 2005 because these costs were not incurred in these years, but were only incurred after a full three-year cycle (app. reply br. at 26, *see also* n.6). This suggests that these costs were not incurred until CY 2006. It appears that appellant’s CY 2006 “overhead cost submission” was filed in June, 2007 (opp’n at 58).

22. On 17 July 2008, DCAA issued an audit report concluding that Raytheon’s accounting for the LTPP violated CAS 415-50(a)(3) and CAS 415-50(e)(1). With respect to the TSR metric, DCAA stated that the “TSR costs are not allowable per FAR 31.205(6)(i) [sic] because the number of shares awarded is dependent on the change in the price of Raytheon’s stock” (ASBCA No. 57679 (57679), R4, tab 2 at 6).⁵ Raytheon contested the government’s position.

23. On 4 September 2009, the CO issued a FDN to Raytheon on this matter related to CYs 2004-2006 (57679, R4, tab 5). By letter to Raytheon dated 1 June 2011, the CO stated that the cost impact with respect to the CAS noncompliance was immaterial (57679, R4, tab 7).

24. However, by letter dated 2 June 2011, the CO issued a final decision, asserting that the costs of the TSR portion of Raytheon’s LTPP were expressly unallowable under FAR 31.205-6(i)(1) because the TSR formula “shows that the stock award to a TSR participant is arrived at by determining the change in stock price” (57679, R4, tab 8 at 2-3). The CO asserted a claim under the Allowable Cost clause to recover the expressly unallowable TSR/LTPP costs for CYs 2004-2006 in the amount of \$1,316,183. The CO added a claim for penalty under the Penalty clause due to Raytheon’s inclusion of these expressly unallowable costs in its final indirect cost rate proposals, in the amount of \$1,316,183 plus interest of \$360,761, for a total of \$2,993,127. In addition, the CO asserted a claim for expressly unallowable dividend equivalent costs for CYs 2005-2006, plus penalty and interest, in the amount of \$662,922. The CO identified the same representative contracts as cited in the earlier CO decision.

25. Raytheon timely appealed this CO decision by notice of appeal dated 7 July 2011. Raytheon appealed the CO decision as it pertained to the questioned TSR costs and penalty; it did not appeal the decision as it pertained to the questioned dividend equivalent costs and penalty. The appeal was docketed as ASBCA No. 57679.

⁵ Insofar as pertinent, FAR 31.205-(6)(i)(1) provides: “Any compensation which is calculated, or valued, based on changes in the price of corporate securities is unallowable.”

DECISION

Appellant captions its request to dismiss these appeals as a motion for declaratory judgment. We have jurisdiction to render declaratory judgments under the CDA involving claims seeking the interpretation or adjustment of contract terms. *Aeronca, Inc.*, ASBCA No. 51927, 01-1 BCA ¶ 31,230 at 154,145. However this is not such a case. Here appellant moves the Board to declare that it lacks jurisdiction over the government's claims. Accordingly, we treat appellant's motion as a motion to dismiss for lack of jurisdiction.

In *Lockheed Martin Corp.*, ASBCA No. 57525, 12-1 BCA ¶ 35,017 at 172,065, we stated as follows:

The timely assertion of a claim within the CDA's six-year presentment period for contractor and government claims, 41 U.S.C. § 7103(a)(4)(A), is a prerequisite to our jurisdiction. *Arctic Slope Native Association v. Sebelius*, 583 F.3d 785 (Fed. Cir. 2009). See also *The Boeing Company*, ASBCA No. 57490, 12-1 BCA ¶ 34,916 (government claim for CAS voluntary accounting change).

Raytheon contends that the government's claims under these appeals were asserted beyond the six-year presentment period and are untimely. In order to assess appellant's contention, we must ascertain when the government's claims accrued.

As of the date of the award of the representative contracts, FAR 33.201 defined "accrual of a claim" as follows:

33.201 Definitions.

As used in this subpart –

"Accrual of a claim" means the date when all events, that fix the alleged liability of either the Government or the contractor and permit assertion of the claim, were known or should have been known. For liability to be fixed, some injury must have occurred. However, monetary damages need not have been incurred.

In determining when a claim accrues and the alleged liability is fixed, we must examine the legal basis of the claim. *Gray Personnel, Inc.*, ASBCA No. 54652, 06-2 BCA ¶ 33,378 at 165,475. Under ASBCA No. 57576, the government seeks to recover increased costs paid by the government under government contracts due to Raytheon's

including the costs of incentive compensation related to expressly unallowable activity in its overhead cost submissions in violation of CAS. The government also seeks to recover penalties due to Raytheon's including such expressly unallowable costs in its final indirect cost rate proposals in violation of the FAR. Under ASBCA No. 57679, the government seeks to recover expressly unallowable TSR/LTPP costs under the FAR Allowable Cost clause, and seeks to recover penalties under the FAR for the inclusion of such expressly unallowable costs in Raytheon's final indirect cost rate proposals.

ASBCA No. 57576 – Alleged Unallowable Incentive Compensation Cost for Persons Performing Expressly Unallowable Activity and Penalty

With respect to CY 2002, the record shows that on 29 September 2003, DCAA issued a memorandum regarding its audit of appellant's bonus and incentive compensation costs for CY 2002, concluding that these costs were fully allowable (SOF ¶ 7). However roughly four years later, by audit report dated 24 September 2007, DCAA determined that portions of these same costs were not allowable for reasons stated herein (SOF ¶ 11). It was this audit report that ultimately led to the government's present claims under this appeal. Based upon the date of the DCAA memorandum, we believe the government should have known – by 29 September 2003 – that the incentive compensation costs in question for CY 2002 were unallowable and should also have known that the government had paid increased costs under government contracts in CY 2002. We also believe that, for purposes of the government's penalty claim for CY 2002, the government should have known by 29 September 2003 that Raytheon had included these expressly unallowable costs in its CY 2002 final indirect cost rate proposal, which had been submitted to the government in or around June 2003 (SOF ¶ 6).

The government's claim letter is dated 10 January 2011, and the government's claims must have accrued no earlier than 10 January 2005 to be timely. We have concluded that the government's claim to recover increased costs paid under government contracts in CY 2002 and the related penalty claim for CY 2002 accrued no later than 29 September 2003. Accordingly, we must conclude that the government's claims for CY 2002 are untimely.

With respect to the government's claim to recover increased costs paid under government contracts for CY 2003, Raytheon's overhead cost submission for CY 2003 was submitted to the government in or around June 2004. As for CY 2004, Raytheon's Corporate Home Office Allocations proposal for forward pricing rates was submitted to the government in September 2004. (SOF ¶¶ 8, 10) We believe the government should have known - prior to 10 January 2005 - of the subject CAS noncompliance and that the government paid increased costs under government contracts as a result in CY 2003 and CY 2004. We are persuaded that the government's claims of 10 January 2011 for these increased costs in CY 2003 and CY 2004 are untimely.

As for CYs 2005-2009, the government could not have been aware, actually or constructively, of any increased costs paid by the government under government contracts in these years until the advent of these years and until payments were made under government contracts in those years. We conclude that the government's claims of 10 January 2011 to recover these increased costs for CYs 2005-2009 are timely.

As for the government's claim for penalties for CY 2003, Raytheon's final indirect cost rate proposal for CY 2003 was submitted to the government in or around June 2004, and we believe that the government should have known - prior to 10 January 2005 - that said final indirect cost rate proposal included these alleged expressly unallowable costs. Hence, the government's claim for penalty for CY 2003 is untimely. As for the government's claim for penalties for CY 2004, Raytheon's final indirect cost rate proposal for CY 2004 was submitted to the government on 2 June 2005, within 6 years of the date of the government's claim letter of 10 January 2011. We are persuaded that the government's claim for penalty for CY 2004 is timely. It follows that the government's claims for penalty for future years, CYs 2005-2009, are also timely.

ASBCA No. 57679 – Alleged Unallowable Costs and Penalty – Total Shareholder Return (TSR) Metric

Under this appeal the government seeks recovery of unallowable costs and penalties for CYs 2004-2006. Based upon DCAA's review of the LTTP in 2004 and the information available to DCAA about the program at that time (SOF ¶¶ 17, 18), we agree with Raytheon that the government should have known by 2004 that the TSR formula was based, in part, upon the price of appellant's stock, which in the government's present view makes the related costs unallowable. However, in order for the government's claim to accrue the government also must have known or should have known of some "injury" to the government by that date. The record fails to show that the government knew or should have known in 2004 or 2005 of any injury to the government based upon Raytheon's application of this metric. Indeed, from the motion papers it appears that appellant did not include the subject TSR/LTTP costs in its CY 2004 overhead cost submission or its CY 2005 overhead cost submission because the subject costs were incurred only after a full three-year cycle (SOF ¶ 21). To the extent these costs were incurred in CY 2006 and were identified in appellant's CY 2006 overhead cost submission of June 2007, the government's 2 June 2011 claim for these costs is timely. It follows that the government's claim for penalties for including such expressly unallowable costs in its final indirect cost rate proposal for CY 2006 is also timely. We conclude that the government's claims under this appeal are timely.

CONCLUSION

For reasons stated herein, appellant's motion under ASBCA No. 57576 is granted in part and denied in part. Appellant's motion under ASBCA No. 57679 is denied.

Dated: 17 December 2012



JACK DELMAN
Administrative Judge
Armed Services Board
of Contract Appeals

I concur



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

I concur



EUNICE W. THOMAS
Administrative Judge
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. 57576, 57679, Appeals of Raytheon Company, rendered in conformance with the Board's Charter.

Dated:

JEFFREY D. GARDIN
Recorder, Armed Services
Board of Contract Appeals