ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Ametek Aerospace Products, Inc.	)	ASBCA No. 45307
	)	
Under Contract No. F34601-91-G-7703-SA33	)	

APPEARANCES FOR THE APPELLANT: Thomas A. Lemmer, Esq.
Janice Davis, Esq.
McKenna & Cuneo
Denver, CO

APPEARANCES FOR THE GOVERNMENT: Jerome C. Brennan, Esq.
Acting Chief Trial Attorney
Debra Berg, Esq.
Defense Contract Management
Agency, Boston

OPINION BY ADMINISTRATIVE JUDGE HARTMAN

The Government contends that appellant, Ametek Aerospace Products, Inc., violated Cost Accounting Standard 404 when it capitalized its asset costs in an amount exceeding the net book value of the assets after all its stock was acquired by its parent company from another company in 1989. According to the Government, for Government contract purposes, appellant must carry on its books the asset values existing on its books before its parent company acquired its stock. Appellant, in contrast, contends that the "business combination" at issue resulted in its acquisition of assets and it must capitalize the cost of acquiring those assets under Cost Accounting Standard 404. According to appellant, it incurred the cost of the acquisition and, as such, is the proper contractor to capitalize the acquisition cost. Appellant contends alternatively that, even if it is not entitled to capitalize the acquisition cost, its parent company is entitled to do so and to allocate that cost to it, resulting in its incurrence of identical cost.

FINDINGS OF FACT

I. General Electric

A. Aviation and Electronics Division

During February of 1988, the Aviation and Electronics Division (AED) of the General Electric Company (GE) announced a business reorganization, disestablishing its

operating or "stand-alone" departments and consolidating for the entire division common functions previously performed within those departments, such as human resources and finance. Thus, AED's "stand-alone" Aircraft Instruments Department (AID), which was located at a plant in Wilmington, Massachusetts, and which comprised a "full profit and loss center with a general manager" and "all . . . functions reporting to it," ceased to exist. Effective February 1988, AID's various product lines and its marketing and engineering activities became AED's Instruments Products Operation (IPO), and its manufacturing, finance and human resource functions each became part of, and reported to, one of AED's centralized functions. (Exs. A-1, -2; tr. 1/44-45, 2/95-99; stip. ¶¶ 9, 14)

Thereafter, at the Wilmington, Massachusetts plant, AED continued to engage in the manufacture and sale of specialized products and systems for commercial and military aircraft (stip. ¶¶ 9, 10). However, all Government contracts performed by IPO were awarded to, and in the name of, GE as contractor, and the Defense Security Agreement applicable to the Wilmington facility was between GE and the Government (stip. ¶¶ 11, 12, 17; tr. 2/98; supp. R4, tab 59) IPO was not a separate legal entity or, for purposes of financial statements given to third parties, a separate accounting entity (stip. ¶¶ 11, 13). Rather, IPO was "an unincorporated business unit" within AED (stip. ¶¶ 11, 14). As of February 1988, AED contained seven such "units" -- four "product line organizations" (IPO, Aircraft Control Systems, Aerospace Electronic Systems, and Infrared Systems and Displays) and three "functional organizations" (Product Operations, Employee Relations, and Finance) which supported the activities of its four product line organizations (stip. ¶ 15; exs. A-1, -2).

B. Sub 64

During May 1986, GE incorporated "Technology, Inc. 64" (Sub 64), under the laws of the State of Delaware. GE held Sub 64's one outstanding share of stock and maintained Sub 64 as a wholly owned subsidiary. (Stip. ¶¶ 19, 20; supp. R4, tab 75)

Prior to 7 August 1989, Sub 64 was an inactive corporation with minimal assets and liabilities, which conducted no business. The income that Sub 64 generated related to interest and royalties on certain intangible assets. Sub 64 never performed any contract, including any contract with the Government, and never had any employees. (Stip. ¶¶ 21, 22, 23, 24)

II. Ametek

Ametek, Inc. (Ametek), is a Fortune 500 corporation that is listed on the New York Stock Exchange and duly organized and existing under the laws of the State of Delaware. In March of 1989, among other activities, Ametek produced and sold aircraft instruments which were "used on virtually every commercial and business jet built in the

free world" and leased and operated a resin compounding facility in Sparta, Tennessee (Sparta plant) (stip. ¶¶ 5, 7; tr. 1/122; supp. R4, tab 63). Dr. Lux, a former GE executive and Ametek's chairman, learned during March 1989 that GE was interested in selling IPO and acquiring Ametek's resin compounding facility (tr. 1/35). Dr. Lux advised Murray Luftglass, Ametek's Vice President of Corporate Development who worked on mergers and acquisitions, that he would be receiving a call from Kidder, Peabody & Co. (Kidder, Peabody), an investment banking firm which GE owned and appointed as its exclusive financial advisor "for the purpose of evaluating financial alternatives with respect to IPO," asking if Mr. Luftglass wished to review a confidential "offering memo." The acquisition of IPO was of "major interest" to Ametek because IPO sold aircraft products similar to those sold by Ametek, but for different size and type airplanes, which were purchased by the same customers that purchased Ametek's products. Thus, when Kidder, Peabody contacted him on 28 March 1989, Mr. Luftglass asked to receive the offering memo and agreed to execute a confidentiality agreement pertaining to the memo. (R4, tab 40 at 3; tr. 1/32, 34-41, 49-51; exs. A-4, -20) Kidder, Peabody then furnished him its 66-page memo introducing IPO to parties who might "be interested in purchasing the stock of the Company." Among other things, the memo stated:

> The Instrument Products Operation ("IPO" or the "Company") of General Electric Company ("GE"), is a leader in providing specialized products and systems for commercial and military aircraft which sense, process and display information regarding aircraft engines and subsystems to both flight and maintenance crews. The Company is an integrated operation with design, development, manufacturing, sales and service capabilities within four primary business areas . . . .

(R4, tab 40 at 6; supp. R4, tab 54)

In April 1989, Ametek and GE began negotiating Ametek's acquisition of the assets relating to IPO's "business line" and GE's acquisition of Ametek's Sparta plant (stip. ¶ 25, ex. A-4). Their negotiations resulted in Ametek and GE agreeing on specific assets necessary to produce, market and sell IPO products, and the associated liabilities which Ametek would acquire (stip. ¶ 26). During late April of 1989, Ametek and GE began negotiating a purchase price for IPO. GE raised structuring the transaction as a sale by GE of Sub 64 stock to Ametek. GE advised Ametek that it was essential "for tax purposes" that the deal be structured in this manner so GE could "recover the value of the business" and GE was "not doing the deal unless it's done this way." GE apparently had a residual tax basis in its Sub 64 stock, which would allow GE to say it had incurred a loss and use that loss to offset its gain on the IPO sale if the transaction was structured as a sale of Sub 64 stock. For tax purposes, however, Ametek wanted a "full cost basis" in the

IPO assets it was acquiring, which ordinarily does not occur if one acquires the stock of a company. Ametek therefore resisted structuring the transaction as a sale of Sub 64 stock "as violently as . . . [it] could," but was told by GE that it was not going to acquire IPO, a "business that Ametek wanted," any other way. (Tr. 1/59-61, 63, 66-74, 82, 2/17-20, 76-78, 89-91; exs. A-8, -29)

On 30 April 1989, an accountant with the firm of Arthur Young advised Ametek that: the "authoritative [legal] case for step-up" of basis in asset values is *Marquardt Co. v. United States*, 822 F.2d 1573 (Fed. Cir. 1987); that "case has been interpreted to cover a broad range of circumstances"; and, while "there are differences [between *Marquardt's* and Ametek's transactions] that allow . . . [Ametek] to argue for a step-up," a step-up "would likely be challenged" by the Government. The accountant additionally advised that; "in evaluating the purchase, . . . [Ametek officials] are under the assumption that [it] will not get the step-up" and, if the IPO deal progresses further, Ametek should "get legal input on this issue." (R4, tab 34 at 3)

Ametek retained a New York law firm to evaluate the IPO transaction and advise regarding Federal income taxation. The law firm was comfortable with structuring the deal as a sale of Sub 64 stock because it believed the Internal Revenue Code (IRC), under specified circumstances, authorized a sale of stock to be treated as if it was an asset sale, allowing Ametek to step-up the basis of the IPO assets it was acquiring for Federal tax purposes. According to the law firm, if the parties deliberately failed the requirements for tax treatment under IRC § 351 by agreeing that IPO's assets would be "dropped into a newly formed corporation or a preexisting corporation that had been stripped clean of any unwanted assets" and that corporation's stock immediately thereafter was sold to Ametek, the transfer would be treated as a taxable sale of the assets by GE, resulting in a full cost basis for the assets for Ametek in determining Federal tax liability. (Tr. 1/115, 2/20, 25, 32-33, 47-48, 76-83)

Ametek's officers were aware from communications with company accountants that the Government might challenge recoverability based upon stepped-up IPO asset values. The officers, however, were not concerned because they assumed the proposed transaction would be treated in the same manner as for Federal tax purposes. (Tr. 1/32, 115, 2/11, 20, 47-48)

III. Sale

On 24 May 1989, Ametek's Board of Directors considered, and approved, the "purchase by the Corporation . . . of GE's Instrument Products Operation, which is engaged in the business of designing, developing, manufacturing and selling engine sensors, signal conditioning and monitoring devices, cockpit instruments and flight reference systems for commercial and military aircraft, for an aggregate purchase price

equal to $110,000,000 in cash, plus an assignment to GE of the Corporation's rights with respect to its plastic compounding facility in Sparta" (stip. ¶ 27). Two days later, on 26 May 1989, GE's Board of Directors met and resolved "that it is desirable and in the best interests of the Company and its Shareholders that the Company sell and dispose of the Instrument Products Operation of GE Aerospace" (stip. ¶ 28; supp. R4, tab 56).

The next week, on 3 June 1989, Ametek and GE entered into a 132-page Purchase and Sale Agreement (P&S Agreement), which provided, in part:

> THIS AGREEMENT is made and entered into as of the 3rd day of June, 1989, between General Electric Company ('GE") . . . and Ametek, Inc. ("Buyer") . . . .
>
> RECITALS
>
> . . . GE owns and operates a business unit of GE head-quartered in Wilmington, Massachusetts, known as the Instrument Products Operation . . . which is engaged primarily in the manufacture and sale of certain specialized products and systems for commercial and military aircraft;
>
> . . . Buyer leases and operates a resin compounding facility . . . located in Sparta, Tennessee . . . ;
>
> . . . [S]ubject to the terms and conditions hereof, GE has agreed to sell and Buyer has agreed to buy the business of IPO, and Buyer has agreed to sell and GE has agreed to buy Buyer's interest in the [Sparta] Plant;
>
> . . . [T]he transaction contemplated hereby will be effected through the transfer of the business of IPO to Sub 64 . . . , the purchase by Buyer and the sale by GE of the stock of Sub 64 and the purchase by GE or a subsidiary of GE and the sale by Buyer of Buyer's interest in the [Sparta] Plant, all on the terms and conditions set forth in this Agreement.
>
> . . . .
>
> Article VIII. Representations and Warranties
>
> 8.1 Representations and Warranties of GE. GE hereby represents and warrants as follows:

. . . .

(w) Adjusted Basis. Immediately before the time of purchase of the Stock of Sub 64 by Buyer or a subsidiary of Buyer from GE, the aggregate adjusted basis for federal income tax purposes of the GE Transferred Assets in the hands of Sub 64 shall be not less than the aggregate adjusted basis such assets would have had in the hands of Buyer if they had been purchased by Buyer directly from GE in a taxable asset sale for an aggregate consideration equal to the aggregate consideration to be paid by Buyer to GE under Article V hereof.

. . . .

Article XIV. Covenants After the Closing

. . . .

14.3 Taxes.

. . . .

(e) GE agrees that, for income tax purposes, it will treat the transfer of the GE Transferred Assets by GE to Sub 64 as a taxable sale of such assets for an aggregate consideration equal to that provided in Article V, and will report such transfer in such manner on all returns and forms filed by it with any taxing authority.

(Stip. ¶ 29(a); supp. R4, tab 1) In addition, on the same date, GE and Sub 64 entered into a "Transfer Agreement," which provided, in part:

. . . GE desires to transfer to Sub 64 the GE Transferred Assets . . . subject to the assumption by Sub 64 of the Related IPO Obligations and Liabilities . . . and, in exchange therefor, to cause Sub 64 to issue one thousand six hundred (1,600) shares of its capital stock to GE;

. . . [S]uch transfer is to occur in connection with and immediately prior to the consummation of the transactions

> contemplated under the Purchase and Sale Agreement . . . dated as of June 3, 1989, between GE and Ametek, Inc. . . . relating to the Instrument Products Operation . . . business unit of the Aircraft Electronics division of the GE Aerospace business group.
>
> . . . .
>
> This Transfer Agreement shall terminate when and only if the Purchase Agreement is terminated.

(Stip. ¶ 30; supp. R4, tab 2)

Shortly thereafter, Ametek announced that it was purchasing GE's IPO operation (supp. R4, tab 63). Dr. Lux, Ametek's chairman, stated that this addition will broaden Ametek's line of aircraft instruments. Dr. Lux added that IPO's "mass fuel flow sensors and transmitters, temperature sensors and optical pyrometers for aircraft engines . . . will complement AMETEK's pressure sensor expertise." (Supp. R4, tab 63)

On 16 June 1989, the Administrative Contracting Officer (ACO) assigned to IPO advised IPO that she was aware GE had announced its intent to sell IPO to Ametek and, if the contractor wished the Government to recognize a successor in interest to its contracts, it should submit to her a proposed novation agreement and other documentation required by Federal Acquisition Regulation (FAR) 42.1204 (ex. G-11; supp. R4, tab 61). By letter dated 6 July 1989, IPO notified the ACO that, on 7 August 1989, the IPO operation "is being sold to AMETEK, Inc.," "[t]he ownership will be the only change," and the "codes currently assigned to the business [should] be transferred to reflect the new . . . ownership" (ex. G-9).

On 7 August 1989, GE and Sub 64 implemented the terms of their Transfer Agreement immediately prior to GE's and Ametek's consummation of the transaction set forth in the P&S Agreement (stip. ¶¶ 34, 35). Effective with GE's and Sub 64's closing of the Transfer Agreement: (a) Sub 64 transferred all of its assets and liabilities to GE; (b) GE transferred to Sub 64 all of the assets and liabilities associated with its IPO business line that Ametek and GE agreed would be transferred; and (c) Sub 64 transferred 1,600 shares of no par value stock to GE. Shortly thereafter, effective with closing of the P&S Agreement, GE transferred 1,601 shares of Sub 64's no par value stock to Ametek and Ametek transferred to GE cash of $100 million plus the Sparta plant, which had been appraised at $9,941,000. (Stip. ¶ 35; supp. R4, tabs 70, 98, 99) Ametek transferred only $100 million in cash to GE at closing of the P&S Agreement because the parties agreed an adjustment to the purchase price was likely due to an inventory discrepancy (stip. ¶ 36; supp. R4, tabs 68, 69).

IV. Ametek Aerospace Products, Inc.

By certificate dated 7 August 1989, the State of Delaware recognized a change in corporate name from Sub 64 to Ametek Aerospace Products, Inc. (AAPI) (stip. ¶ 39). The same date, Sub 64's directors, who were employees of GE, resigned their positions and AAPI installed its own directors who had not served previously as Sub 64 directors (stip. ¶¶ 50, 51, tr. 2/41-42; supp. R4, tabs 60, 71). AAPI entered into a union agreement effective 7 August 1989, with the union that previously represented GE employees, and established pension, medical, dental, life insurance, disability, 401(k) and other benefit plans for former GE employees now in its employ (stip. ¶¶ 46, 47, tr. 1/163-65, 188; ex. A-34).

The Government issued a Department of Defense Security Clearance to AAPI on 7 August 1989 for the former GE/IPO facility at Wilmington. However, it suspended its progress payments under GE contracts transferred to AAPI, stating GE could no longer certify progress payment requests, AAPI did not have its own accounting system, and AAPI could not certify such payment requests until it entered into a novation agreement. (Stip. ¶¶ 53, 54; ex. G-11; supp. R4, tabs 73, 77, 79, 80, 81, 84, 88, 90, 92, 100, 101, 102, 106 through 109, 111, 114, 117)

By letter dated 10 August 1989, AAPI advised the Government that Ametek "has purchased the GE-IPO business," "plans to leave . . . [its] facility in place in Wilmington under current management guaranteeing the current level of capability and competence," and "will be fully capable of carrying out the provisions of all contracts listed in . . . [its] novation request" (ex. G-8). While AAPI initially used GE's accounting system, AAPI quickly implemented its own system. It filed a new Cost Accounting Standards (CAS) Disclosure Statement with the Government during September of 1989, effective on 8 September. (Stip. ¶¶ 42, 49; ex. G-11; supp. R4, tabs 79, 83)

V. Transaction Accounting

Initial "purchase accounting" entries were made on the books and records of AAPI and Ametek beginning 7 August 1989 based upon estimates, and these initial entries were adjusted periodically through March 1990 (stip. ¶ 61; R4, tabs 15, 16). On 22 March 1990, pursuant to their P&S Agreement, GE and Ametek agreed to an adjustment in the purchase price of $20,693,000 based upon an inventory discrepancy and deficiency in net worth. Because $10 million of the adjustment to the purchase price was recognized as of 7 August 1989 through a reduction in cash paid at closing, the net downward adjustment agreed to was $10,693,000. This adjustment reduced the total consideration furnished GE under the P&S Agreement from $117,866,000 to $107,173,000, comprising $89,307,000

in cash paid by Ametek, $9,941,000 for the Sparta plant that Ametek transferred to GE, and $7,925,000 for GE liabilities which were assumed by AAPI. (Stip. ¶¶ 57, 58)

Ametek made payments to third parties for costs of structuring and implementing the transaction totaling $1,128,000. The total cash ($89,307,000), other consideration ($9,941,000), and third party costs ($1,128,000) paid by Ametek with respect to the IPO transaction thus equaled $100,376,000. (Stip. ¶¶ 57, 58, 59, 60; R4, tab 16)

On 31 March 1990, Ametek reflected this sum on its books and records through the following entry:

Intercompany Accounts Receivable	$100,376,000	
Investment in Aerospace		$100,376,000

(Stip. ¶ 63; R4, tabs 16, 38) The same date, AAPI adjusted its books and records, as of 7 August 1989, to reflect the final "purchase accounting" for the transaction as follows:

Accounts Receivable		$10,038,000
Allowance for Bad Debts		($673,000)
Inventories		$45,992,000
Progress Payments Received		($6,012,000)
Reserve for Obsolete Inventory		($1,193,000)
Other Current Assets		$473,000
Net Property Plant and Equipment		$25,400,000
Identified Intangibles		
Patents	$11,800,000	
Technology	$11,545,000	
Assembled Work Force	$3,400,000	
Covenant Not to Compete	$5,725,000	$32,470,000
Goodwill		$1,806,000
Total Assets		$108,301,000
Accounts Payable:		$3,798,000
Accrued Liabilities:		$3,412,000
Loss Contract Reserve:		$715,000
Intercompany Payable-Ametek		$100,376,000
Total Liabilities & Equity		$108,301,000

(Stip. ¶ 64; R4, tab 16; supp. R4, tab 251)

Ametek and its wholly owned subsidiary, AAPI, subsequently filed a consolidated Federal tax return. That tax return reflected the assets which were formerly related to IPO

at "stepped-up" values established under "purchase accounting," less depreciation and amortization. (Stip. ¶¶ 6, 65) Tangible and intangible capital asset values utilized were as follows:

CAPITAL ASSET VALUES (000's)

	Presale	Opening	Incremental		Service Lives
	GE Balance	Ametek Balance	Included In Rates	Excluded From Rates	(starting 7 Aug. '87)
Tangible Capital Assets					
Plant & Equipment	$8,283	$20,350	$12,067	$0	7 yr. avg.
Leasehold Improvements	2,146	2,220	74	0	15
Building Lease	0	2,830	2,830	0	6½
Total Tangibles	$10,429	$25,400	$14,971	$0	
Intangible Capital Assets					
Patents	0	11,800	9,865	1,935	9
Technical Asst Agreement	0	945	0	945	7
Product Drawings	0	5,250	0	5,250	7
Product Specs/Procedures	0	565	565	0	7
Product. Dev. & Test S/W	0	4,135	2,068	2,068	7
MIS Software	0	650	650	0	2
Work Force	0	3,400	3,400	0	6
No Compete Covenant	0	5,725	0	5,725	7
Goodwill	0	1,805	0	1,805	30
Total Intangibles	$0	$34,275	$16,548	$17,728	

(Stip. ¶ 67; supp. R4, tab 105) Since 7 August 1989, AAPI has utilized its stepped-up asset values for tangible capital assets to calculate depreciation costs and cost of money for Government contract pricing purposes and its stepped-up asset values for intangible capital assets to measure amortization costs for Government contract pricing purposes (stip. ¶¶ 68, 69; R4, tabs 26, 30; supp. R4, tab 118; ex. G-6).

VI. Government Contracts

Starting 7 August 1989, AAPI used its assets which were formerly related to GE/IPO to perform Government contracts (stip. ¶ 71; ex. G-10). On 14 August 1990, AAPI, the Government and GE entered into a novation agreement where the Government agreed to recognize AAPI as the successor in interest to contracts awarded

GE/IPO as of 7 August 1989 (stip. ¶ 74). This novation agreement was consistent with the standard-form novation agreement found at FAR 42.1204 (stip. ¶ 75).

During the parties' negotiation of a novation agreement, the Government sought a three-year prohibition upon AAPI recognizing for Government contract purposes any cost increases arising from GE's sale of assets relating to IPO, including specifically any costs based upon the values on AAPI's books and records for tangible and intangible capital assets, to the extent those values were higher than the values GE recognized on its books and records for those assets. The Government, however, ultimately agreed to accept the limitation against recognition of cost increases under novated contracts provided in the standard-form novation agreement. (Stip. ¶¶ 76, 77)

After 7 August 1989, the Government awarded additional contracts to AAPI upon which Ametek is a corporate guarantor (stip. ¶ 70). For example, effective 2 March 1991, the Department of the Air Force entered into a Basic Ordering Agreement (BOA), No. F34601-91-G-7703, with AAPI, which included FAR 52.230–3 COST ACCOUNTING STANDARDS (SEP 1987) and 52.230–4 ADMINISTRATION OF COST ACCOUNTING STANDARDS (SEP 1987), and awarded pursuant to the BOA on 9 April 1992 an order, No. SA33, in the amount of $3,283,000 (stip. ¶¶ 1, 2, 3; R4, tab 1).

On 10 August 1990, the Defense Contract Audit Agency (DCAA) issued Audit Report No. 2160-0B160141-057 citing AAPI for noncompliance with CAS 404 on the ground that AAPI was "stepping up" assets for which it had incurred no cost because Ametek, and not AAPI, had purchased the stock of Sub 64 and incurred the cost thereof. Less than two weeks later, on 22 August 1990, DCAA issued another audit report, No. 2160-OB442154-0613, finding that AAPI also failed to comply with CAS 404 and FAR 31.205-11 by utilizing the purchase method of accounting for valuing former GE/IPO assets and measuring costs based upon those values. (Stip. ¶¶ 73, 78; R4, tabs 2, 3)

On 12 September 1990, the Administrative Contracting Officer (ACO) issued an "Initial Finding" that "AAPI is in violation of CAS 404 and FAR 31.205-11 as cited in the . . . [10 and 22 August] audit report" (stip. ¶ 79; R4, tab 5). During October of 1990, AAPI asserted by letter that it was in compliance with both CAS 404 and FAR 31.205-11 (stip. ¶ 80; R4, tab 6). In January of 1991, representatives of Ametek met with the ACO and DCAA to discuss the ACO's Initial Finding (stip. ¶ 81; R4, tabs 11, 12). During September 1991, one year after his Initial Finding, the ACO stated in a memorandum to the file that he had determined "the CAS 404 and FAR 31.205-11 noncompliances to be unsupported by DCAA," and communicated that conclusion to AAPI (stip. ¶¶ 83, 84; supp. R4, tabs 134, 135).

DCAA's regional office thereafter learned from GE that GE "recognized a gain of $45,905,000 on the sale to Ametek" and GE did not believe the Government was "entitled

to share in this gain because it resulted from the sale of stock, not from the sale of assets" (supp. R4, tab 136). On 4 October 1991, the regional office sought guidance concerning AAPI's step-up of asset values. It stated in a memorandum to its headquarters that:

> Ametek claims that the substance, not the form, of the transaction should govern. Consequently, it claims that the asset write-up should be allowed, since it was an asset purchase and not a stock purchase. It claims that at no time prior to the purchase and sale agreement . . . had the IPO business operated as a separate legal entity. . . . IPO did not maintain its own financial books and records. IPO was not an internal reporting entity; it was part of the Aircraft Electronics Division, which was the profit center/internal reporting unit.
>
> The DCAA office noted in its audit report and other correspondance [sic] to the . . . [ACO], that, although a business combination had taken place, it was in fact an acquisition of stock and not an acquisition of assets, and thus, the asset write-up should not be allowed. It further noted that AAP[I] is not allowed to use the Purchase Method as provided in . . . APB 16 since AAP[I] was the acquired company and not the acquiring company. It notes that under APB 16, the purchase method of accounting is available to the acquiring business. This was confirmed by the Armed Services Board of [Contract] Appeals in the Marquardt case. It concludes that Ametek, Inc. was the acquiring company and that Technology Inc. 64, subsequently renamed Ametek Aerospace Products, was the acquired company.
>
> . . . .
>
> . . . In our opinion, the acquisition by Ametek, Inc. on 3 June 1989 is a stock purchase. On that date, GE entered into an agreement with Ametek, Inc., wherein Ametek agreed to buy the business of IPO by purchasing the capital stock . . . of Technology Inc. 64. After the acquisition, AAP[I] remained separate and autonomous. The systems, financial records, and data used by AAP[I] were the same as used by GE. In reviewing GE's accounting treatment of the sale to Ametek, Inc., we found that GE accounted for the sale as a stock sale . . . . In our opinion, both GE and Ametek

> should handle the transaction in the same way, not in different ways that benefit each contractor individually.
>
> . . . Ametek misinterprets DCAA's position concerning Ametek, Inc. being the acquiring company. It concludes that if Ametek, Inc. is the acquiring company, DCAA should allow the asset write-up on the corporate books. It reasons that since CAS 403 requires home office expenses to be allocated to the operating segments, additional depreciation expense would flow down to AAP[I]. This is a misinterpretation of our position. Our argument is not that Ametek is the acquiring company and the written up asset should be on the acquiring company's books, but rather Ametek, Inc. is the acquiring company in a stock purchase and, as such, has not incurred a cost, but rather acquired an investment. Investments are accounted for as assets and not expense. The acquired company essentially remained the same after the acquisition as before. [Emphasis in original]

(Supp. R4, tab 137) During February 1992, DCAA headquarters advised that it agreed with its regional office that the increased costs associated with the revaluation of AAPI assets acquired from GE were unallowable and that it had coordinated its determination with the headquarters for Defense Contract Management Area Operations Boston (supp. R4, tabs 143, 145, 147).

Approximately three months later, on 6 May 1992, the ACO issued to AAPI a determination of noncompliance with CAS 404 and requested submission of an impact statement (stip. ¶ 86; R4, tab 20). Shortly thereafter, AAPI gave a presentation to the ACO on 13 May 1992 setting forth why it believed it was in compliance with CAS 404 and disagreed with DCAA's conclusions (stip. ¶ 87; R4, tab 21). In a final decision dated 28 July 1992, the ACO determined that AAPI had not complied with CAS 404 and FAR 31.205-11, and that costs based upon asset values resulting from the purchase method of accounting were unallowable. The ACO stated:

> . . . Since AAPI was the acquired rather than the acquiring company and AAPI has incurred no cost associated with the acquisition, it is not entitled to use the purchase method of accounting prescribed by CAS 404 (Capitalization of Tangible Assets).
>
> Furthermore, in a stock purchase situation without a subsequent liquidation of assets, the difference between

> the book value and the purchase price of the acquired corporation's assets should be reflected on the financial books and the records of the acquiring co[r]poration, not the acquired corporation.
>
> . . . .
>
> Ametek, Inc. purchased the [IPO] business activity as a capital acquisition in which AAPI remained separate and autonomous. As stated earlier, they [sic] were and continue to be a going concern. . . . Therefore, AAPI's assets should be depreciated on the basis of their historical costs (less residual values over the useful lives . . .). Because AAPI's depreciation charge was not based on historical costs that were reflected in the contractor's books of accounts and financial statements before the write-up . . . , it was not reasonable.

(Stip. ¶ 89; R4, tab 24 at 2)

AAPI timely appealed the ACO's decision to this Board, citing Contract No. F34601-91-G-7703-SA33 (stip. ¶¶ 89, 90; R4, tab 25). During a five-day hearing before the Board, Ametek presented two expert witnesses -- William T. Keevan, a certified public accountant, partner, and Managing Director of Government Contract Consulting Services for Arthur Andersen & Co., and Nelson H. Shapiro, a certified public accountant who drafted CAS 404 while serving as associate director of the Cost Accounting Standards Board (tr. 3/82, 4/6-8, 33-34, 103). Mr. Keevan testified, among other things, that: "the Sub 64 stock transaction was absolutely meaningless"; AAPI is the "acquirer" or "buyer" of IPO's "assets" because it has an "account payable" to Ametek for the purchase price; AAPI must be viewed as "substantively" different than Sub 64 even though legally AAPI might be Sub 64 with a new name; and with respect to business combinations, "substance clearly takes precedent over form from an accounting perspective" (tr. 3/82-86, 123-24, 156, 170-71, 210, 215-16, 223). Mr. Shapiro testified, among other things, that: one should "ignore Sub 64" because interim steps are to be ignored in determining the true economic facts of a transaction; "from an accounting viewpoint," the "substance" of the transaction here was the purchase of assets -- "AAPI acquired the assets of IPO formerly owned by GE"; when Sub 64/AAPI's stock was purchased, Sub 64/AAPI did not possess a single asset different than before the stock purchase; one could say the court of appeals held in *Marquardt* that a Government contractor incurred no costs when its stock was sold from one owner to another and that the Government received no benefit as a result of that stock sale; the appeals court, however, did not look at the latter issue from the point of view of CAS 403; and he

cannot address the sale of Sub 64/AAPI stock because that is a "legal transaction" which "doesn't deal with the accounting for the transaction" (tr. 4/54-56, 107-09, 117-19, 121-25).

DECISION

The Government asserts that, when AAPI capitalized its assets in an amount which exceeded the net book value of those assets after Ametek acquired all its stock from GE during 1989, AAPI violated CAS 404 because, for Government contract purposes, AAPI must carry on its books the asset values existing before Ametek acquired its stock (Gov't br. at 45-59; Gov't reply at 1-9). AAPI asserts that the 1989 "business combination" at issue in this appeal resulted in its acquisition of the assets and that, under CAS 404, it properly capitalized the cost of acquiring those assets (app. br. at 87-104; app. reply at 55-81).

CAS 404 requires that the acquisition costs of tangible capital assets be capitalized based upon a written policy that is reasonable and consistently applied. 4 C.F.R. § 404.40 (1990). "However, it is axiomatic that costs chargeable either directly or indirectly to Government contracts must actually be incurred." *E.g.*, *R&D Associates*, ASBCA Nos. 30738, 30750, 86-3 BCA ¶ 19,062 at 96,272; FAR 31.201-1 (total cost of a contract is the sum of allowable direct and indirect costs allocable to the contract incurred or to be incurred). Thus, the threshold issue presented is whether, as a result of the 1989 "business combination" at issue here, AAPI "incurred" any asset acquisition cost required to be capitalized.

In *Marquardt Co. v. United States*, 822 F.2d 1573, 1574 (Fed. Cir. 1987), one company, CCI Corporation (CCI), sold all the stock of a subsidiary company engaged in Government contracting, Marquardt Company (Marquardt), to another company, ISC Electronics, Inc. (ISC). After becoming a wholly owned subsidiary of ISC, Marquardt utilized the purchase method of accounting to allocate the price ISC paid for its stock among its assets and adjusted its schedule of indirect costs to reflect the increases in depreciation and facilities capital cost of money. *Id*. The court of appeals affirmed this Board's holding that Marquardt had incurred none of the disputed costs, that only costs incurred by Marquardt could be charged to Marquardt's contracts, and that Marquardt's step-up of assets was therefore improper. *Id*. at 1577; *accord Riverside Research Inst. v. United States*, 860 F.2d 420, 423-24 (Fed. Cir. 1988), *modified on other issues*, 877 F.2d 952 (Fed. Cir. 1989); *Newport News Shipbuilding & Dry Dock Co.*, ASBCA Nos. 44731, 44826, 97-1 BCA ¶ 28,835 at 143,851, *aff'd on recon.*, 98-1 BCA ¶ 29,692, *aff'd* 185 F.3d 884 (Fed. Cir. 1999) (table); *Times Fiber Communications, Inc. & Times Microwave Systems, Inc.*, ASBCA No. 37301, 91-2 BCA ¶ 24,013 at 120,219.

The facts in *Marquardt* closely resemble those surrounding Ametek's purchase of stock from GE. We found above that, on 7 August 1989, (1) GE transferred (a) assets and liabilities associated with its IPO line of business to a wholly owned subsidiary, Sub 64, and (b) all shares of Sub 64 stock to Ametek for consideration exceeding $100 million, and (2) the State of Delaware recognized a change in the corporate name of Sub 64 to "AAPI." In addition, we found above that, since AAPI's "renaming," AAPI: performed contracts for the Government using the assets of GE's IPO line of business; adjusted its books and records to reflect purchase accounting for the GE "transaction;" utilized its stepped-up asset values for tangible capital assets to calculate the depreciation costs and cost of money for Government contract pricing purposes; and used its stepped-up asset values for intangible capital assets to measure amortization costs for Government contract pricing purposes. Accordingly, similar to Marquardt, AAPI used the purchase method of accounting to allocate the "price" its new parent company had paid for its stock among its assets and adjusted its schedule of indirect costs to reflect those increases in depreciation and facilities capital cost of money.

AAPI essentially contends that its appeal is distinguishable from *Marquardt* for five reasons: (1) the existence of an account payable to Ametek means AAPI actually incurred the acquisition cost; (2) the "substantive effect" of the transaction here was a transfer of assets; (3) the user of the assets here changed significantly; (4) the parties to this appeal executed a novation agreement; and (5) the acquisition here clearly benefits the Government. AAPI's five purported distinctions, however, are without merit.

While AAPI asserts initially that it incurred the cost of acquiring the GE/IPO assets by incurring a firm and irrevocable liability to Ametek in an amount equal to the cash and Sparta plant Ametek transferred to GE, acceptance of its assertion would require us to ignore elementary principles of corporate law. As found above, Ametek acquired from GE the stock of AAPI. It is a fundamental principle of corporate law that a corporation (AAPI) and its stockholders (Ametek) are separate entities, and that title to the corporate property is vested in the corporation (AAPI) and not in the owner of the corporate stock (Ametek). *E.g.*, *Moline Properties, Inc. v. Comm'r*, 319 U.S. 436, 439 (1943); *Algonac Mfg. Co. v. United States*, 428 F.2d 1241, 1243, 1249 (Ct. Cl. 1970). AAPI, therefore, possessed title to its capital assets upon the sale of all its stock to Ametek, continued to possess title to those assets after the sale of all its stock to Ametek, and could not, as a matter of law, have "incurred" expense to acquire title to those assets by creation of an "account receivable" upon the books of a stockholder, Ametek, after the sale of its stock to that stockholder. *See Monterey Life Systems, Inc. v. United States*, 635 F.2d 821, 825 (Ct. Cl. 1980). Accordingly, despite AAPI's suggestions to the contrary, we are not free to ignore the separate corporate existences of AAPI and Ametek. *Id*.

AAPI, relying principally upon its accounting experts, additionally asserts that the "substantive effect" of the transaction between GE and Ametek was a transfer of assets,

not stock, and form should not take precedence over substance for purposes of AAPI's Government contracts. According to AAPI, it was Ametek's intent to purchase IPO's assets and the IRC allows Ametek to step-up the basis of AAPI's assets on Ametek's consolidated financial statements as if Ametek purchased IPO assets from GE. Federal tax law historically has recognized some transactions as asset purchases, notwithstanding that the transactions were "in form" stock acquisitions. *E.g.*, Rev. Rul. 70-140, 1970-1 C.B. 73*; see Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938) (transactions undertaken as part of a plan may be recharacterized for Federal income tax purposes to ensure that a "given result at the end of a straight path is not made a different result because reached by following a devious path"). The Federal tax law, however, is not necessarily relevant to, much less binding upon, our resolution of Government-contract cost accounting issues. *Marquardt Co. v. United States*, 822 F.2d at 1579; *accord Old Colony R.R. v. Comm'r*, 284 U.S. 552, 562 (1932) ("rules of accounting enforced upon a carrier by the Interstate Commerce Commission are not binding upon the [Internal Revenue] Commissioner"); *Lulejian & Assocs., Inc.*, ASBCA No. 20094, 76-1 BCA ¶ 11,880 at 56,949. For example, we held in *Eaton Corp.*, ASBCA No. 34355, 93-2 BCA ¶ 25,743 at 128,097, *aff'd*, 26 F.3d 140 (Fed. Cir. 1994) (table), that the fact a corporation had realized a taxable "recapture of depreciation" was not sufficient to establish that the same contractor had realized such a gain for Government contract purposes. Thus, the fact that GE and Ametek are to treat the transaction at issue here as a sale of assets for Federal income tax purposes simply is not controlling with respect to how AAPI should account for the acquisition of its stock by Ametek for purposes of AAPI's Government contracts. Accordingly, while the IRC may require adoption of a "legal fiction" that there was a sale of assets, rather than a sale of stock by GE, to preclude avoidance of payment of income tax, we need not, and do not, abide by such a fiction when reviewing AAPI's Government contract cost accounting.

While AAPI also asserts that the user of the assets here changed significantly and that IPO's assets essentially are "in the hands of a new user," in making these assertions, AAPI misconstrues this Board's decision in *Times Fiber Communications, supra*, 91-2 BCA ¶ 24,013. In that case, we found that: the acquired company merged with its acquiring company; the surviving corporation (the acquired company) possessed the assets and liabilities of both companies; and, although the acquired company retained its formal "legal identity" after the merger, it was not the same company which existed before, but one with "many significant factual differences." *Id*. at 120,202, 120,217-18. We, therefore, held the acquired company had "incurred" the costs of the combination at issue and could step-up its asset values for purposes of its cost accounting. *Id*. at 120,218, 120,220. In stating that the acquired company was "different" than the company which existed previously, we were not holding that, whenever there is a stock sale, there must be a factual inquiry and determination with respect to whether the resulting company is somehow "different" than the company existing before the sale, as AAPI appears to suggest in its briefs. Rather, we were simply noting that the acquired company

had become liable for the transaction's financing due to the "merger" and had thereby "incurred" the cost of the transaction even though it retained its formal "legal" identity. *Id*. at 120,218. There was no merger or liquidation here which made AAPI liable legally for financing of Ametek's stock purchase, and AAPI does not so contend. Thus, AAPI's various assertions -- that it is a significantly "different" entity than before the sale of its stock because Ametek transformed it from a non-stand-alone business being used principally to generate cash for its parent into a praiseworthy, stand-alone business by investing millions of dollars in capital improvements -- are simply not relevant to the threshold issue here of whether AAPI incurred the cost it seeks to capitalize under CAS 404.

AAPI's further assertion -- that its appeal differs from *Marquardt* because the parties here executed a novation agreement -- miscomprehends the court of appeals' decision in *Marquardt*. While the parties in *Marquardt* did not execute a novation agreement, the appellate court drew no distinction in that case between execution and non-execution of a novation agreement. Rather, the Court expressly stated that the parties' execution of "a novation agreement would merely formalize what is already implicit, namely: [the] Cost of depreciation relating to . . . [pre-stock sale] existing contracts would continue to be allowed based on Marquardt's (and not ISC's) historical costs in the event of acquisition." 822 F.2d at 1577–78. The existence here of a novation agreement, therefore, is a distinction without relevance. *See id*.

AAPI's last asserted distinction -- that the acquisition here, unlike that in *Marquardt*, clearly benefits the Government -- similarly miscomprehends the court of appeals' decision in *Marquardt*. In discussing this Board's initial and reconsideration decisions in that case, the appeals court noted that the Board stated in its initial decision that the disputed "costs were not allocable to Marquardt's contracts because they were not incurred specifically for the benefit of a Government contract, and no benefit to Marquardt's contracts resulted from the acquisition." *Id*. at 1575. However, in affirming our ruling that Marquardt was not entitled to step-up its depreciable assets to reflect the price ISC paid for its stock, the appeals court did not examine whether the Government received any benefit from the sale of Marquardt's stock or impose any type of "benefit" test to determine if Marquardt was entitled to step-up its depreciable assets. Instead, as discussed above, the appeals court simply held that Marquardt was not entitled to step-up the assets because ISC, not Marquardt, incurred the acquisition costs. *Id*. at 1577; *see Riverside Research Inst.*, 860 F.2d at 423-24 (*Marquardt* stands for the unexceptional proposition that a cost may not be charged against the Government unless that cost is actually incurred by the contractor). Thus, whether the sale of AAPI's stock to Ametek "has benefited, and continues to benefit, not only AAPI but also the government," simply is irrelevant to the threshold issue here of whether AAPI incurred the cost sought to be capitalized under CAS 404.

In sum, AAPI, like Marquardt, used the purchase method of accounting to allocate among its assets the "price" that its new parent company paid for its stock and adjusted its schedule of indirect costs to reflect the attendant increases in depreciation and facilities capital cost of money. We therefore conclude the appeals court's holding in *Marquardt* -- that a parent's cost of acquiring all the stock of a new wholly-owned subsidiary is not an expense incurred by the acquired company and thus a step-up of assets by the acquired company is improper for Government contract cost accounting purposes -- clearly applies to and governs this appeal.

AAPI argues in the alternative that, if it is not entitled to capitalize its new parent's "acquisition cost," then the new parent (Ametek) is entitled to do so and to allocate the cost to AAPI under CAS 403, and that the "resulting cost is identical" to that recorded and disputed here (app. br. at 104-12; app. reply at 82-87). The Government argues that: Ametek "never allocated [to AAPI] amortization, depreciation or cost of money based [up]on these assets as a 'home office expense'"; the Board should not address AAPI's contention because it "lacks jurisdiction to render advisory opinions"; and, even if the Board elects to address the contention, Ametek is not free to allocate the expense to AAPI because there is no "beneficial or causal relationship" necessary for allocation (Gov't br. at 60-61).

The Government previously filed a motion to dismiss paragraph 38 of AAPI's complaint on the ground that the paragraph, which asserts AAPI's alternative contention, seeks an "advisory opinion" beyond our jurisdiction. The Board, however, denied that jurisdictional motion. *Ametek Aerospace Products, Inc.*, ASBCA No. 45307, 94-1 BCA ¶ 26,531 at 132,053. Under the "law of the case doctrine," our prior ruling is controlling, unless one of the recognized, "exceptional circumstances" justifying a departure from the doctrine exists. *E.g., McDonnell Aircraft Co.*, ASBCA No. 37346, 96-1 BCA ¶ 28,164 at 140,572. The Government does not assert that any "exceptional circumstance" justifying a departure from the doctrine exists and we are not aware of any such circumstance. We, therefore, must also address AAPI's alternative contention.

In *Newport News Shipbuilding & Dry Dock Co.*, ASBCA Nos. 44731, 44826, 97-1 BCA ¶ 28,835 at 143,849-51, a parent company (Tenneco Corp.) amortized its cost of acquiring all the stock of a new subsidiary (Newport News) which was in excess of the net book value of the subsidiary's assets (goodwill amortization), and then allocated that cost to its new subsidiary. This Board held that the subsidiary's claims for its parent's goodwill amortization under various Government contracts were barred by *Marquardt Co.*, 822 F.2d 1573. *Newport News*, 97-1 BCA at 143,851-52. In a motion for reconsideration, the subsidiary argued that, in rendering its decision, the Board "failed to consider the applicability and effect of CAS 403." The Board stated, however, in its reconsideration decision that, in formulating its initial decision, it "considered all of the various contentions raised . . . , including [appellant] Newport News's arguments relating

to CAS 403" and that "none of appellant's assertions swayed the Board from its view that the outcome . . . was governed by the Federal Circuit's decision in *Marquardt*." *Newport News Shipbuilding & Dry Dock Co.*, ASBCA Nos. 44731, 44826, 98-1 BCA ¶ 29,692 at 147,156. The court of appeals subsequently affirmed this Board's decisions. *Newport News Shipbuilding & Dry Dock Co. v. Dalton*, 185 F.3d 884 (Fed. Cir. 1999) (table).

This Board and the appeals court, thus, held in *Newport News* that a contractor cannot escape the appeals court's holding in *Marquardt* -- that a subsidiary cannot recover a parent's cost of acquiring its stock in excess of net book value, which it did not "incur" -- by re-characterizing that cost as an allocation of expense under CAS 403. *Newport News*, 97-1 BCA ¶ 28,835 at 143,851-52, *aff'd on recon.*, 98-1 BCA ¶ 29,692 at 147,156, *aff'd*, 185 F.3d 884 (Fed. Cir. 1999) (table). Accordingly, as stated above in discussing CAS 404, the appeals court's holding in *Marquardt* applies to and governs this appeal.

Based on our ruling that *Marquardt* governs, we need not address AAPI's contentions concerning CAS 405 and FAR 31.205-52. In sum, in seeking to recover its parent company's cost of acquiring its stock exceeding net book value, AAPI is not in compliance with CAS.

CONCLUSION

The appeal is denied.

Dated: 6 September 2000

TERRENCE S. HARTMAN
Administrative Judge
Armed Services Board
of Contract Appeals

(Signatures continued)

I concur

MARK N. STEMPLER
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 No. 45307, Appeal of Ametek Aerospace Products, Inc., rendered in conformance with the Board's Charter.

Dated:

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