ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
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BAE Systems Information & Electronic Systems Integration, Inc. (formerly Lockheed Martin IR Imaging Systems, Inc., and Loral Infrared and Imaging Systems, Inc.)	)	ASBCA No. 44832
	)	
Under Contract No. N62269-90-C-0554	)	

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OPINION BY ADMINISTRATIVE JUDGE HARTMAN
ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

In this appeal, the Government contends that Federal Acquisition Regulation (FAR) 31.205-52, ASSET VALUATIONS RESULTING FROM BUSINESS COMBINATIONS, "disallows" costs claimed under a cost-reimbursement contract which arise from appellant's "write-up" of its asset values pursuant to a "business combination." According to the Government, after the FAR's effective date, if a contractor utilizes the purchase method of accounting for a business combination, its allowable amortization, cost of money and depreciation are limited to the total of the amounts that would have been allowed had the combination not taken place. Appellant, in contrast, contends that FAR 31.205-52 bars costs arising from a "write-up" of asset values only with respect to business combinations occurring after the effective date of the regulation. Alternatively, appellant contends it is not barred from claiming increased amortization, cost of money, and depreciation arising from a business combination occurring before the effective date of the regulation because: (1) the

Government's administrative contracting officer (ACO) failed to exercise independent judgment in issuing his final decision disallowing the costs; (2) application of the FAR comprises a taking of property without just compensation; and (3) FAR 31.205-52 is invalid because (a) the process of drafting and promulgating it "was a sham," (b) it is arbitrary and capricious, (c) it is an illegal retroactive regulation, and (d) it conflicts with the Cost Accounting Standards regarding "allocation" of costs.

STATEMENT OF FACTS

Prior to December 1989, Honeywell, Inc. (Honeywell), a corporation organized under the laws of the State of Delaware, maintained an operation known as the Electro-Optics Division (EOD), which performed Government contracts for about 80 percent of its work. (Complaint (Compl.) ¶ 5; Respondent's Motion For Summary Judgment (Gov't SJM) at 1; Government (Gov't) Reply exhibit (ex.) 16; Appellant's Motion for Summary Judgment (app. SJM) at 6) EOD comprised a "fourth-tier" unincorporated unit. EOD was part of and reported to Honeywell's Military Avionics Group, which in turn was part of and reported to Honeywell's Space and Aviation Systems Business. The Space and Aviation Systems Business in turn was part of and reported to Honeywell's corporate headquarters. (Compl. ¶ 6; Gov't SJM at 2)

On 8 December 1989, Honeywell and Loral Corporation (Loral) executed a Purchase and Sale (P&S) Agreement whereby Loral agreed, upon a subsequent closing, to acquire substantially all of the assets of EOD and assume part of the liabilities Honeywell had incurred with respect to EOD's operation. (Compl. ¶ 7; Respondent's Answer (ans.) ¶ 7; Gov't SJM at 2; app. SJM at 6-7) About two weeks later, on 26 December 1989, in contemplation of its acquisition of EOD, Loral amended the Certificate of Incorporation of Frequency West, Inc., a wholly-owned corporate subsidiary utilized primarily for acquiring new business lines, to change the subsidiary's name from "Frequency West, Inc." to "Loral Infrared and Imaging Systems, Inc." (LIRIS) (compl. ¶ 8; ans. ¶ 8; Gov't SJM at 2-3).

Honeywell, Loral, and LIRIS executed an Assignment, Assumption, and Guaranty Agreement dated 31 December 1989. Pursuant to the agreement, Loral assigned to LIRIS all of its rights under the P&S Agreement, LIRIS assumed all of Loral's obligations under the P&S Agreement, and Honeywell consented to Loral's assignment and the assumption by LIRIS. (Compl. ¶ 9; ans. ¶ 9; Gov't SJM at 2-3)

Closing of the sale of EOD's assets occurred on 31 December 1989. Pursuant to the P&S Agreement, LIRIS paid Honeywell $56 million for substantially all of the assets used by EOD in the conduct of its business and Honeywell executed an "Assignment and Bill of Sale" to LIRIS. (Compl. ¶¶ 10, 11, 13; ans. ¶¶ 10, 11; Gov't SJM at 3-4; app. SJM at 7)

On the same date, 31 December 1989, LIRIS, Honeywell, and the Government entered into a novation agreement. Under that agreement, LIRIS assumed responsibility for performing over 60 Government contracts originally awarded to Honeywell. (Gov't SJM at 3-4 & ex. 1; R4, tab 155)

Concurrent with acquisition of the EOD assets, LIRIS consolidated the assets owned by it/Frequency West with those of EOD acquired from Honeywell into a single accounting entity (compl. ¶ 12; Gov't SJM at 4). LIRIS utilized the "purchase method" of accounting contemplated by Accounting Principles Board Opinion No. 16 (APB 16) with respect to the "business combination" at issue (compl. ¶ 19, ans. ¶ 19; Gov't SJM at 4 & ex. 2; app. SJM at 7). When utilizing the "purchase method" of accounting, APB 16 requires an acquiring entity to record the assets acquired on its books at their fair value at time of the acquisition. An acquiring company, therefore, is required to have the assets it purchased appraised and have a determination made of the fair value of those assets. LIRIS accordingly retained the services of Enterprise Appraisal Co. to determine the fair market value of the tangible assets it purchased from EOD and hired Coopers & Lybrand to determine the fair market value of the intangible assets it purchased, including all patents and computer software. (Compl. ¶¶ 14, 15, 19; Gov't SJM at 4-5; app. SJM at 7; R4, tab 173)

Subsequently, LIRIS utilized the fair market value of the assets determined by the valuation companies as the basis for calculation of depreciation and amortization expense arising from such cost. In addition, LIRIS began notifying the ACO of proposed forward pricing rates, which reflected the cost of the acquired assets. (Compl. ¶¶ 21, 24, 26; ans. ¶¶ 24, 26; Gov't SJM at 5; app. SJM at 7; R4, tabs 1, 2, 3, 4)

On 21 June 1990, the Government published a "new" cost principle, FAR 31.205-52 entitled "ASSET VALUATIONS RESULTING FROM BUSINESS COMBINATIONS," and related amendments to other cost principles in the Federal Register as final rules, with an effective date of 23 July 1990. 55 Fed. Reg. 25,522.

About three months later, on 29 September 1990, the Naval Air Development Center awarded LIRIS Contract No. N62269-90-C-0554 for "IR Detector Coldshielding and Retroreflection Enhancement." This cost-reimbursement contract for performance of classified work incorporated various standard clauses, including FAR 52.216-7 ALLOWABLE COST AND PAYMENT (APR 1984), which stated in pertinent part:

> (a) *Invoicing*. The Government shall make payments to the Contractor when requested as work progresses, . . . in amounts determined to be allowable by the Contracting Officer in accordance with Subpart 31.2 of the Federal Acquisition Regulation (FAR) in effect on the date of this contract and the terms of this contract. . . .

The contract also incorporated by reference FAR 52.230-3 COST ACCOUNTING STANDARDS (AUG 1986) and FAR 52.230-4 ADMINISTRATION OF COST ACCOUNTING STANDARDS (APR 1984). (R4, tab 6 at 13-14; compl. ¶ 31; ans. ¶ 31; Gov't SJM at 6; app. SJM at 8)

Pursuant to the provisions of Contract No. N62269-90-C-0554, on 25 March 1991, LIRIS submitted to the Government Invoice No. 7A seeking payment of $2,087.00 for "an overhead adjustment consisting solely of step-up of asset values arising out of the acquisition of the assets of the Honeywell Inc. Electro-Optics Division by Loral . . . on December 31, 1989." During July 1991, the Defense Contract Audit Agency (DCAA) issued a "Form 1" for Invoice No. 7A disallowing the claimed indirect costs, as well as the associated cost of money and fee, pursuant to FAR 31.205-52. (Compl. ¶¶ 32, 33; ans. ¶¶ 32, 33; app. SJM at 8-9; Gov't SJM at 6; R4, tabs 9, 10, 11, 12)

On 1 August 1991, the Government's ACO advised other agency personnel that, at that time, it was his opinion the FAR did not apply to pre-existing business combinations such as that of LIRIS (app. SJM ex. 1). The ACO sought advice from the Price/Cost and Financial Analysis Branch of the Defense Logistics Agency (DLA) and was informed by memorandum dated 26 August 1991 that, in the opinion of the Branch, LIRIS's asset revaluation and resultant costs should be allowed because the EOD "sale predated the effective date of FAR 31.205-52" (app. SJM ex. 2).

By audit report dated 31 December 1991, DCAA found LIRIS in noncompliance with Cost Accounting Standard (CAS) 405.40(a), FAR 31.201-6 and FAR 31.205-52. DCAA stated:

> As a result of the business combination, the contractor restated its asset values to reflect fair market value. The amount reflected for depreciation expense in the contractor's submission include allowances for the amortization of a $15.6 million and $8.4 million step-up of intangible and fixed assets respectively. The excess depreciation claimed is unallowable per FAR 31.205-52 which states [that] "depreciation shall be limited to the total of the amounts that would have been allowed had the combination not taken place." Simply stated, the Government will not recognize for cost allowability purposes any increase in the value of acquired assets . . . as a result of business combinations.
>
> Furthermore, the contractor is in noncompliance with CAS 405.40(a) requirements and FAR 31.201-6 which states "costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable

> directly associated costs, shall be identified and excluded from any billing, claim or proposal applicable to a Government contract.[”]

(R4, tab 15)

By letter dated 20 February 1992, LIRIS requested that the ACO issue a final decision regarding the DCAA Form 1 (R4, tab 16). The ACO received his warrant in 1987 and never before had been involved in a cost dispute or issuance of a final decision (app. SJM ex. 13). The ACO consulted with legal counsel regarding issuance of a final decision, and obtained both DCAA and headquarters guidance before reaching a decision (app. SJM exs. 9, 16; app. supp. R4, tabs 168 through 171). He concluded that “the cost principle required that you disallow that step-up” and that the date of the contract, not the date of the business combination, was “the operative date” (app. SJM exs. 4, 11, 66; app. supp. opp. ex. 9). The ACO believed he had discretion to contradict DCAA guidance, but did not feel there was any reason to do so because he believed the DCAA guidance to be correct. After having reviewed FAR 52.216-7 ALLOWABLE COST AND PAYMENT (APR 1984) and the guidance he received, he felt that the cost principle applied to the LIRIS combination, and he would not issue a decision disallowing the costs “if he didn’t feel that way.” (App. SJM exs. 4, 6, 9, 10, 11, 13)

On 17 April 1992, the ACO issued a final decision, which disallowed the costs submitted for payment in Invoice No. 7A based on the language of FAR 31.205-52 (R4, tab 17). By letter dated 30 April 1992, the ACO advised: pursuant to the DCAA audit report and review which resulted in his final decision, LIRIS is in noncompliance with FAR 31.205-52; also “a noncompliance with CAS 405.40(a) and FAR 31.201-6 exists”; and, in future billings and proposals to the Government, “LIRIS should identify and exclude unallowable costs associated with the asset valuation resulting from the business combination” and the “allowability of costs should be based on the acquired company’s book value of the existing assets before the combination took place.” (Compl. ¶ 34; ans. ¶ 34; Gov’t SJM at 6; app. SJM at 9; R4, tab 18)

LIRIS timely appealed the ACO’s final decision to this Board (R4, tab 19). The Government moved to dismiss the appeal for lack of jurisdiction on the ground LIRIS’s $2,087 invoice constituted a contractor claim which required certification, even though the invoice was less than $50,000 in amount, because LIRIS’s appeal was a “test case” which “has application beyond the amount at issue in the Appeal.” The parties filed various briefs regarding the Government’s jurisdictional contention and subsequently this Board denied the Government’s motion. *Loral Infrared and Imaging Systems, Inc.*, ASBCA No. 44832, 94-1 BCA ¶ 26,518.

After the parties had engaged in some discovery, the Government filed a motion for summary judgment and LIRIS filed an opposition to the Government’s motion (app. opp.).

The Board suspended action on the Government's motion pending completion of further discovery and granted LIRIS leave to supplement its opposition upon completion of discovery. Subsequently, LIRIS filed a supplement to its opposition (app. supp. opp.). Three weeks after LIRIS filed its supplemental opposition, it submitted its own summary judgment motion. The Government then filed a reply to LIRIS's supplemental brief and an opposition to LIRIS's summary judgment motion (Gov't reply). The same week that the Government filed its sur-reply and opposition to LIRIS's summary judgment motion, Ametek Aerospace Products, Inc. (Ametek), filed a motion for leave to file an *amicus curiae* brief in this appeal because it was "involved in an appeal that involves . . . FAR § 31.205-52" and "the illegality of FAR § 31.205-52 is an issue . . . critical to a vast array of government contractors." The Board thereafter granted Ametek leave to file an *amicus* brief in this appeal (*amicus* br.) and in a related appeal, *Kearfott Guidance & Navigation Corp.*, ASBCA No. 45536. *See Boeing Co*., ASBCA No. 28342, 85-3 BCA ¶ 18,435 at 92,598-99, *aff'd*, 802 F.2d 1390 (Fed. Cir. 1986). After the Board issued its decision in *Ametek Aerospace Products, Inc.*, ASBCA No. 45307, 00-2 BCA ¶ 31,080, denying that appeal in September of 2000, LIRIS sought and obtained leave for the parties to file another supplemental brief here (app. supp. br.; Gov't supp. br.).

During the course of this appeal, two other corporations "acquired" the appellant. Thus, at the suggestion of the appellant, we substituted as the party of record "Lockheed Martin IR Imaging Systems, Inc.," and then "BAE Systems Information & Electronic Systems Integration, Inc." For ease of reference in this decision, however, we utilize the terminology set forth above to refer to appellant.

ACCOUNTING FRAMEWORK

For purposes of accounting, a "business combination" occurs when a corporation and one or more incorporated or unincorporated businesses are brought together into a single accounting entity. That one entity then carries on the activities of the previously separate, independent enterprises. Accounting Principles Board (APB) Opinion No. 16 at ¶ 1 (Gov't SJM ex. 2).

Before World War II, accountants classified most business combinations either as a "merger," the acquisition of one company by another, or as a "consolidation," the formation of a new corporation. Accounting for both types of combinations generally followed traditional principles for the acquisition of assets or issuance of shares of stock. (*Id*. at ¶ 9)

After World War II, accountants shifted their emphasis in classifying business combinations from the legal form of the combination to distinctions between "a new ownership" or "continuance of the former ownership." "New ownership was accounted for as a purchase; continuing ownership was accounted for as a pooling of interests." (*Id*. at ¶ 10)

The "purchase method of accounting" accounts for a business combination as the acquisition of one company by another. Under this method, the "acquiring corporation" records at its cost the acquired assets less liabilities assumed and, thereafter, the reported income of the acquiring corporation "includes the operations of the acquired company after acquisition, based on the cost to the acquiring corporation." (*Id*. at ¶¶ 11, 21) The method adheres to the traditional principles of accounting for the acquisition of assets. Supporters of the "purchase method" of accounting for business combinations believe –

> [A]n acquiring corporation accounts for the economic substance of the transaction by applying those principles and by recording:
>
> a. All assets and liabilities which comprise the bargained cost of an acquired company, not merely those items previously shown in the financial statements of an acquired company.
> b. The bargained costs of assets acquired less liabilities assumed, not the costs to a previous owner.
> c. The fair value of the consideration received for stock issued, not the equity shown in the financial statements of an acquired company.
> d. Retained earnings from its operations, not a fusion of its retained earnings and previous earnings of an acquired company.
> *e. Expenses and net income after an acquisition computed on the bargained cost of acquired assets less assumed liabilities, not on the costs to a previous owner.*

(*Id*. at ¶ 21 (emphasis added))

The "pooling of interests method" of accounting accounts for a business combination as the uniting of the ownership interest of two or more companies by exchange of equity securities. No acquisition is recognized because the combination is accomplished without disbursing "constituent resources." Ownership interests continue and former bases of accounting are retained. The recorded assets and liabilities simply are carried forward to the combined corporation at their recorded amounts. (*Id*. at ¶¶ 12, 51, 52)

The pooling of interests method was first applied in accounting for combinations of affiliated corporations and then extended to some combinations of unrelated corporate ownership interests of comparable size. The method later was accepted for most business combinations in which common stock was issued. (*Id*. at ¶ 13)

During the 1960s, some business combinations required the issuance of new and complex securities, and for additional securities to be issued subsequently depending on specified events. Some combinations which were effected by both disbursing cash and issuing securities were accounted for as a "part purchase, part pooling." (*Id*.)

In 1970, after publication of two studies on accounting for business combinations by the Director of Accounting Research for the American Institute of Certified Public Accountants, the APB issued its Opinion, No. 16, which found that: "some business combinations should be accounted for by the purchase method"; "other combinations should be accounted for by the pooling of interests method," and that a "single method should be applied to an entire combination," thereby barring the practice known as "part-purchase, part-pooling." In its opinion, the APB specified the circumstances in which each method should be applied and the procedures to be followed when applying each method. This opinion modified prior opinions of the APB and its predecessor. (*Id*. at ¶¶ 3-5, 7, 8, 42-48, 50-96)

COST ACCOUNTING STANDARDS BOARD

In 1970, under Pub. L. No. 91-379, § 103, 84 Stat. 796-99 (formerly codified at 50 U.S.C. App. § 2168, repealed by Pub. L. No. 100-679, § 5(b), 102 Stat. 4055, 4063 (1988)), Congress chartered a Cost Accounting Standards Board (CASB), which would be chaired by the Comptroller General and would be independent of the Executive departments, to "promulgate standards designed to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts." Congress specified that cost standards promulgated by the CASB would: take effect unless Congress passed within 60 days a concurrent resolution of disapproval; have the "full force and effect of law"; and "be used by all relevant Federal agencies and by defense contractors and subcontractors in estimating, accumulating, and reporting costs" in connection with pricing, administration and settlement of specified United States procurements. Pub. L. 91-379, 84 Stat. 796-99 (formerly codified at 50 U.S.C. App. § 2168(h)(3) and (i)(A)).

The CASB subsequently promulgated a Statement of Objectives, Policies, and Concepts (Statement of Objectives), and 19 cost accounting standards. The Statement of Objectives set forth the following regarding "cost allocation concepts":

> In order to achieve increased uniformity and consistency in accounting for costs of negotiated defense contracts, Cost Accounting Standards should provide criteria for the allocation to cost objectives of the cost of resources used. A cost objective as defined by the Board is "a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to

> accumulate and measure the cost of processes, products, jobs, capitalized projects, etc." Standards deal with all aspects of cost allocability, including:
>
> 1. The definition and measurement of costs which may be allocated to cost objectives,
>
> 2. The determination of the cost accounting period to which such costs are assignable, and
>
> 3. The determination of the methods by which costs are to be allocated to cost objectives.
>
> The Board will adhere to the concept of full costing whenever appropriate. Full allocation of all costs of a period, including general and administrative expenses and all other indirect costs is considered by the Board generally to be the basis for determining the cost of negotiated defense contracts.
>
> Under the full costing concept, all costs initially allocated to intermediate cost objectives must be subsequently reallocated to final cost objectives. *For this purpose, a final cost objective may be established to include unreasonable costs or costs unallowable for other reasons.*

COST ACCOUNTING STANDARDS GUIDE ¶ 2923 at 4032 (CCH 1984) (emphasis added). With respect to the difference between "allocability" and "allowability," the Statement of Objectives provided:

> The CASB does not determine categories or individual items of cost that are allowable. Allowability is a procurement concept affecting contract price and in most cases is established in regulatory or contractual provisions. An agency's policies on allowability of costs may be derived from law and are generally embodied in its procurement regulations. A contracting agency may include in contract terms or in its procurement regulations a provision that will refuse to allow certain costs incurred by contractors that are unreasonable in amount or contrary to public policy. In accounting terms, those same costs may be allocable to the contract in question.
>
> Allocability is an accounting concept involving the ascertainment of contract cost; it results from a relationship between a cost and a cost objective such that the cost objective appropriately bears all or a portion of the cost. For a particular cost objective to have allocated to it all or part of a cost there should exist a beneficial or causal relationship between the cost objective and the cost.

> Cost Accounting Standards provide for the definition and measurement of costs, the assignment of costs to particular cost accounting periods, and the determination of the bases for the direct and indirect allocation of the total assigned costs to the contracts and other cost objectives of these periods. The use of Cost Accounting Standards has no direct bearing on the allowability of those individual items of cost which are subject to limitations or exclusions set forth in the contract or which are otherwise specified as unallowable by the Government.

COST ACCOUNTING STANDARDS GUIDE ¶ 2920 at 4030-31 (CCH 1984). Among the cost accounting standards promulgated by the CASB were CAS 404, 409 and 414, 48 C.F.R. §§ 30.404, 30.409, 30.414 (1990). CAS 404, "CAPITALIZATION OF TANGIBLE ASSETS," published in 1973, CAS 409, "DEPRECIATION OF TANGIBLE CAPITAL ASSETS," published in 1975, and CAS 414, "COST OF MONEY AS AN ELEMENT OF THE COST OF FACILITIES CAPITAL," published in 1976, all related to the accounting treatment for long-term assets after the occurrence of a business combination. CAS 404.40(a) provided that "acquisition cost of tangible capital assets shall be capitalized" based on "a written policy that is reasonable and consistently applied." CAS 404.50(d) and (e) provided:

> (d) Under the "purchase method" of accounting for business combinations, acquired tangible capital assets shall be assigned a portion of the cost of the acquired company not to exceed their fair value at date of acquisition. Where the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess.
>
> (e) Under the "pooling of interest method" of accounting for business combinations, the values established for tangible capital assets for financial accounting shall be the values used for determining the cost of such assets.

48 C.F.R. § 30.404 (1990). CAS 409 provided that the depreciable cost of a tangible capital asset shall be its capitalized cost less its estimated residual value, and specified various criteria for assigning the depreciable cost of tangible capital assets to cost accounting periods and allocating such costs to cost objectives within such periods, including the proper treatment of gains and losses upon disposition of tangible capital assets. 48 C.F.R. § 30.409 (1990). CAS 414, Appendix A provided that "facilities capital

values used should be the same values that are used to generate depreciation." 48 C.F.R. § 30.414 (1990).

After 10 years, Congress did not renew funding for the CASB and the CASB came to an end on 30 September 1980. *E.g.*, *Bar Group Favors Making CASB Independent To Avoid Constitutional Problems*, 71 FED. CONTRACTS REP. 183 (1999); PAUL TRUEGER, ACCOUNTING GUIDE FOR GOVERNMENT CONTRACTS 182 (10th ed., 1991). In 1982, a defense contractor challenged the validity of the CAS and the constitutionality of the CASB, but the United States Court of Claims did not consider or rule upon the issue because the Department of Defense (DoD) itself had adopted the disputed CAS and was authorized to do so. *Boeing Co. v. United States*, 680 F.2d 132, 140-41 (Ct. Cl. 1982). The next year, the Supreme Court issued its decision in *INS v. Chadha*, 462 U.S. 919 (1983), holding that a "legislative veto" was unconstitutional and, "to become law," the President must sign legislation passed by the two Houses.

During the early 1980's, several attempts were made to revive the CASB, but the attempts failed. In May 1984, DoD's Deputy Under Secretary (Acquisition Management) directed the Defense Acquisition Regulatory Council to assume all responsibility for the maintenance and promulgation of cost accounting standards, rules, and regulations, based on advice from the Department of Justice. *Gilleece Directs DAR Council To Take Over CAS Function*, 41 FED. CONTRACTS REP. 967 (1984); *DoD Lays Groundwork For New CAS Board*, 41 FED. CONTRACTS REP. 149 (1984); PAUL TRUEGER, ACCOUNTING GUIDE FOR GOVERNMENT CONTRACTS 183 (10th ed., 1991).

Almost four years later, during the fall of 1988, Congress created a new CASB chaired by the Administrator of the Office of Federal Procurement Policy (OFPP). Pub. L. No. 100-679, § 5(a), 102 Stat. 4055, 4059 (codified at 41 U.S.C. § 422 (1988)). The new OFPP CASB issued a recodification of the CAS in 1992, placing the CAS at 48 C.F.R. Chapt. 99, and during 1996 amended CAS 404.50(d) to provide:

> (d) The capitalized value of tangible capital assets acquired in a business combination, accounted for under the "purchase method" of accounting, shall be assigned to these assets as follows:
>
> (1) All the tangible capital assets of the acquired company that during the most recent cost accounting period prior to a business combination generated either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be capitalized by the buyer at the net book value(s) of the asset(s) as reported by the seller at the time of the transaction.

> (2) All of the tangible capital asset(s) of the acquired company that during the most recent cost accounting period prior to a business combination did not generate either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be assigned a portion of the cost of the acquired company not to exceed their fair value(s) at the date of acquisition. When the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess.

48 C.F.R. § 9904.404-50(d) (1996). Among the public comments considered before promulgation of the revised CAS 404 were that a deviation from generally accepted accounting principles (GAAP) was not warranted and that it is inequitable for the Government to benefit from all savings resulting from restructuring when it does not recognize all costs needed to implement such restructuring. With respect to the former, the CASB stated it "decided to proceed with the 'no step-up, no step-down' approach . . . establishing a cost accounting practice that diverges from the . . . practice recognized for GAAP purposes" only after extensive consideration of possible alternatives, including the issues associated with recognition, allocation and recovery of gain or loss subsequent to a merger or business combination. With respect to the latter, the OFPP CASB stated:

> . . . In issuing this revision, the Board does not intend to encourage or discourage contractors to consolidate or restructure their operations. Rather, the Board's intent, in accordance with its stated objectives, in promulgating this revision, is to increase the degree of uniformity and consistency in like circumstances in the cost accounting practices that are used by Government contractors to record tangible capital asset values subsequent to mergers or business combinations. The Board believes that this action will result in cost allocations that are fair and equitable.

61 Fed. Reg. 5,520-22 (1996). The OFPP CASB also added a new subparagraph to CAS 409.50 making clear that CAS provisions dealing with recapture of gains and losses on disposition of tangible capital assets did not apply to business combinations. 48 C.F.R. § 9904.409-50(j)(5) (1996).

REGULATORY FRAMEWORK

During the 1980s, business combinations within American industry and, more specifically, within the defense industry became far more common. This development was deemed of particular importance to the Government procurement community because business combinations could dramatically alter a company's cost structure upon which much of Government contract pricing ultimately is based. (App. SJM ex. 3 at 1-2, 9)

In February 1984, the Defense Acquisition Regulatory (DAR) Council requested that the Commercial Cost Principles Committee (CPC) study issues regarding appropriate treatment of costs arising from mergers and other business combinations, and recommend changes in cost principles coverage with respect to such costs it deemed appropriate. As a result, the DAR Council established DAR Case 84-18, "Accounting for Mergers and Other Business Combinations." (App. SJM ex. 3 at 1, which also appears in the record as app. supp. R4, tab 102)

CPC responded to the DAR Council request in a 4 February 1987 report (app. SJM ex. 3). In its report, the CPC noted that APB 16 "drastically restricted the situations to which the 'pooling' approach could be applied, and made the 'purchase' approach the standard one to be used," and thus "it has become typical for transactions regarded as business combinations to result in asset revaluations." (*Id*. at 9) The CPC further noted that the CAS indicate that the CASB assumed "asset revaluations" resulting from business combinations would form the basis for the calculation of allocable depreciation expense and facilities capital cost of money (FCCM) in subsequent accounting periods. (*Id*. at 14-15) The CPC thereafter reviewed accounting theory relating to issuance of APB 16 and the Government's historical treatment of the sale of individual assets, which the CPC found did not envision application of the specific "depreciation recapture" rule to business combination situations. (*Id*. at 9-10, 12-14) Based on its analysis, the CPC set forth two possible approaches to the issue of "asset revaluation" in "the cost principles" — (1) recognize asset revaluations resulting from business acquisitions with altered depreciation and FCCM amounts in accounting periods subsequent to the acquisition, subject to the recapture of excess depreciation borne by prior Government contracts or (2) simply not recognize, for purposes of Government contract costing and pricing, asset revaluations resulting from business combinations. (*Id*. at 19) The CPC stated that:

> In choosing between these two broad approaches, the Committee majority is persuaded that the fundamental issue here is one of how best to achieve fairness. Both the "depreciation recapture" and the "no recognition" approaches are, in the final analysis, nothing more than devices to ensure that what constitutes good accounting for business acquisitions does not create a situation that is "unfair" to the Government.

> In the opinion of the Committee, it is on this basis that the choice between these two approaches should be made.

(*Id*.) CPC concluded that, when measured by a fairness standard, "the approach of simply not recognizing depreciation or FCCM charges flowing from asset revaluation ought to be the basic Government rule." (*Id*.)

The CPC explained that, while dogmatic insistence that asset revaluations arising from business combinations be respected as "good accounting" leads to seeking equity through a depreciation recapture approach, extension of a depreciation recapture approach to business combinations does not make sense and is not equitable because the approach is designed to deal with a very different set of circumstances – the frequent transfer of individual assets between independent, on-going companies where any particular asset disposition might "recapture" more or less depreciation at time of disposition than was actually borne in prior periods, but such variations would offset one another over time so that the outcome would be fair to both contractors and the Government. The CPC added that, for this reason, the depreciation recapture rule set forth in the cost principles and its restatement in the CAS contemplate situations such as a mass disposition of assets where the recapture rule is to be abandoned in favor of case-by-case negotiation, and that every "business combination" is tantamount to a "mass disposition" of assets. (*Id*. at 19-20)

In recommending nonrecognition of changes to depreciation expense or FCCM flowing from asset revaluations following business combinations, the CPC stated that there is "a long-standing tradition in Government contracting, expressed in both the cost principle on 'Organization costs' and in the language of the standard novation agreement, that the Government should be placed in no worse a position by a change in business ownership than it would have been in had the change not taken place." The CPC added that "this is a reasonable and practical way to define what is equitable in such situations not only to the Government, but also to the contractors involved who are, after all, as much at risk as the Government under the 'depreciation recapture' approach." (*Id*. at 20)

The CPC noted this was the same approach it had employed in promulgating FAR 31.205-49 (OCT 1984), disallowing "goodwill" generated under the purchase method of accounting after it found that goodwill caused the Government to pay more for an item after a merger than before, creating an inequitable situation, and that the mere fact that accountants recognized goodwill as a cost did not, by itself, lead automatically to the conclusion the cost should be reimbursed by the Government. (*Id*. at 16-18) The CPC added, however, that implementation of a rule not recognizing changes to depreciation expense and FCCM flowing from asset revaluations would be more complex than the "goodwill" non-recognition rule it previously issued. It explained that the Government might be confronted with past asset revaluations arising from a business combination that took place when (a) the acquired contractor had no, or virtually no, Government business or

(b) the Government was given a "depreciation recapture" credit at the time of asset revaluation. (*Id*. at 21-22)

To permit legitimate exceptions by a contracting officer (CO) faced with a specific business combination, while laying down a general policy of disallowance, the CPC recommended that the new rule be included within the goodwill cost principle, and that changes be made to CAS 404 and 409 to delete language accepting the purchase method of accounting for business combinations and providing for depreciation recapture. (*Id*. at 22-23) While the CPC believed the language proposed to be deleted from the CAS would not constitute "an 'impermissible conflict' between the CAS and the cost principles of the kind found by the courts" in *United States v. Boeing Corp*., 802 F.2d 1390 (Fed. Cir. 1986), because the new cost principle "would constitute an 'allowability' rule in the narrowest sense," the CPC saw "no reason for the Government to run whatever litigative risk" was inherent in allowing the language to remain. (*Id*. at 23-24)

On 12 March 1987, the CPC issued a supplemental report because some members of the DAR Council believed the CPC's February 1987 report could be misinterpreted with respect to the relationship between the cost principles and CAS. The CPC stated again in its supplemental report that, while litigative risk is real and cannot be assessed precisely before the commencement of a suit, even without the proposed CAS deletions, it believed that "there would probably not be an 'impermissible conflict' of the sort found by the courts in . . . Boeing." (App. SJM ex. 4 at 1-2)

After the CPC submitted its supplemental report, the DAR Council decided to divide the case into two subcases — separating cost principles that could stand alone from those associated with revisions to CAS. Subsequently, accounting for mergers and other business combinations was addressed in DAR Case 84-18B. (App. SJM ex. 5 at 1-2)

On 7 December 1988, the DAR Council closed DAR Case 84-18B, which contained the recommended non-recognition of asset revaluation and proposed CAS change. The reason for closure was passage of the Office of Federal Procurement Policy Act Amendments of 1988, creating a new CAS Board and vesting authority to change the CAS in that Board. The DAR Council then established a new case on the same subject, designated as DAR Case 88-146, to pursue an approach which did not rely upon changes to the CAS and could be implemented immediately to protect the Government's interest. (App. SJM exs. 6, 7)

On 31 January 1989, to avoid any possible confusion, the CPC advised the DAR Council that, rather than amending the goodwill cost principle by adding language with respect to asset revaluation, it proposed creating a new cost principle, FAR 31.205-52. The new principle would contain language similar to that to be added previously and provide: "When the purchase method of accounting for a business combination is used, allowable amortization, cost of money, and depreciation shall be limited to the total of the amounts that would have been allowed had the combination not taken place." (App. SJM ex. 5 at tab A, p. 4, exs. 9, 10) The CPC also proposed corresponding changes to FAR 31.205-10, COST OF MONEY, 31.205-11, DEPRECIATION, and 31.205-16, GAINS AND LOSSES ON DISPOSITION OF DEPRECIABLE PROPERTY OR OTHER CAPITAL ASSETS. (App. SJM ex. 9)

The DAR Council approved Case 88-146, and recommended the case be approved by the Civilian Agency Acquisition Council (CAAC) and published as a proposed rule. On 19 February 1989, the acting chairman of the CAAC recommended that the CAAC approve the case as submitted in order to obtain public comments, even though he had some reservations regarding the mechanics of the proposed new rule. (App. SJM ex. 11) He appended to his recommendation a FAR staff analysis providing in part:

> The intent of this wording is to look through the business combination and to use the same net book values of the assets in the new company as were used in the old company for purposes of determining depreciation expense, etc. . . .
>
> While the intent of the rule is certainly appropriate and attempts to implement a rule like it have been underway for some time now, the proposed rule appears to have a significant complication. The rule properly eliminates the asset writeups resulting from the purchase of a company and clearly communicates what may not happen; i.e., there can be no writeup. However, the rule is silent on what must happen; i.e., it does not identify the book values that must be used for the assets. For example, if Company A has changed hands four times in the last six years, the rule could be read to require book value to be determined by the value on the books of the first owner. However, going back to the first owner may not always be appropriate and it is the intent of the Cost Principles Committee . . . that the transaction be traced back only as far as makes sense.
>
> The Cost Principles Committee feels sure that the rule will be read and administered in the way they intend regardless of the rule's silence.

(*Id*.) Subsequently, the CAAC approved the case and comments were solicited regarding the proposed changes in the 1 May 1989 Federal Register. 54 Fed. Reg. 18,634-35 (Gov't SJM ex. 3).

Among the 24 entities commenting on the proposed changes was the law firm representing *amicus curiae*, McKenna & Cuneo. The law firm commented, in part, that "the proposed [FAR] language overreaches because it would apply to business combinations consummated year[s] ago but which still affect the cost of contracts." The law firm added that "[t]hese past business combinations . . . were entered into based upon the allowability of the resulting costs." (Gov't SJM ex. 4 at 1-2, 7-8, ex. 5 at 1)

During October of 1989, after studying the comments received in response to the proposed changes, the CPC recommended the proposed cost principle not recognizing increased costs arising from business combination asset revaluations be converted to a final rule (Gov't SJM ex. 5 at 1). With respect to the comments of counsel for *amicus* and five others regarding the reach of the rule and the "ample" protection afforded the Government by the contract novation process, the CPC stated:

> Th[e] question of the proper reach of a no-write-up rule has been a controversial aspect of the merger case since its inception. The position taken by the industry commenters is rooted in the notion that each contract between a contractor and the Government stands on its own with the parties being free to contract or not. If that is the case, then the Government enters with its eyes open as to the cost basis of the contractors' assets. They believe that the Government is only entitled to wipe away the effects of the asset write-up when the combination took place between contract signing and completion.
>
> This quaint line of reasoning does not fit modern times in the defense/aerospace systems business. The Government and a major systems contractor almost always pass a point of no return, after which the contractor has no where else to sell his product and the Government has no where else to buy it. In these sole source circumstances, prices tend to be based upon costs. While novation agreements can provide the Government with some protection, the Committee does not believe it to be sufficient.
>
> [McKenna &] Cuneo's point about the retroactivity of the rule has merit in those instances where the merger was done when the entity had little or no Government business. This point was among many that were covered in the more full blown passes at this case by the Committee and the CAS Policy Group in years past under Case No. 84-18. We do not believe there are many contractors in this position and do not think such a refinement to be necessary.

(*Id*. at 9; app. SJM ex. 13 at 9) With respect to the comments of counsel for *amicus* and six other entities that business combinations are good for the defense industrial base and the new rule will hurt the defense industry, the CPC stated:

> The commenters seem to be confused as to which types of capital investment the Government customers do, and should, appreciate. . . . The capital investment involved in a business combination brings no new capital assets to the contracts. They are the same assets that were there before the combination took place. If major defense work were done in a real marketplace in which factors other than cost determined price, prices to customers would not rise because a business combination had been consummated. Government contract prices should not be at the mercy of a circular process in which assets are sold for an amount in excess of their book value, creating higher book values and sales prices to Government customers. . . . Real capital investment, from the Government's viewpoint, is that which brings new assets to the job. . . .
>
> . . . .
>
> That the revised rule will serve to reduce profits that would otherwise have occurred is true enough. That doesn't take the discussion anywhere though. The rule is intended to not reward that part of "investment" that brought no new capital assets to the job. The disfavor of Government profit centers when making corporate investment decisions is a problem that Government policymakers have struggled with for a long time. It goes to the nature of how contract prices are set (i.e. based on cost). The system for arriving at contract profits can overreward costly but inefficient capital because it is done according to more-or-less rigid formulas. The thought of rewarding the non-existent capital improvements represented by the bookkeeping of a business combination has brought this method to its choking point.
>
> [McKenna &] Cuneo's conjecture that deserving small suppliers may sometimes survive by combining was considered carefully by the Committee because the problem of the loss of small suppliers is real. However, a business combination is not the only way to infuse needed capital into an enterprise. It is just the only one that raises that part of prices paid for investment without actually bringing in new buildings or

> equipment. The Committee does not believe that the cost accounting rules should encourage asset churning as a means of economic survival.

(Gov't SJM ex. 5 at 7-9; app. SJM ex. 13 at 7-9) Finally, with respect to concerns expressed by two commentators regarding the different treatment afforded purchases of individual assets, the CPC stated:

> The language proposed for 31.205-52 employs the presence of the purchase method of accounting in a business combination as its triggering mechanism. That method's source within accounting literature is APB No. 16, which clearly deals with the economic substance of transactions and overrides legal form where it differs. The proposed rule's method of identification of a business combination should be as good as APB No. 16, which went into effect in 1970 and appears to be working satisfactorily.

(Gov't SJM ex. 5 at 11; app. SJM ex. 13 at 11)

On 18 October 1989, the DAR Council approved the final rule and forwarded it to the CAAC for approval (app. SJM ex. 14). Six weeks later, on 29 November 1989, the CAAC approved the case as a final rule (app. SJM ex. 16). On 21 June 1990, the new cost principle, FAR 31.205-52, and its related amendments were published as final rules, with an effective date of 23 July 1990. 55 Fed. Reg. 25,522 (1990).

DECISION

In this appeal, both parties seek entry of summary judgment. Board Rule 5(b) authorizes us to entertain and rule on motions for summary judgment. *E.g.*, *J.W. Creech, Inc.*, ASBCA Nos. 45317, 45454, 94-1 BCA ¶ 26,459 at 131,661. The standards set forth for FED. R. CIV. P. 56 guide us in resolving such motions. *Lear Siegler, Inc.*, ASBCA No. 30224, 86-3 BCA ¶ 19,155 at 96,794; *Allied Repair Service, Inc.*, ASBCA No. 26619, 82-1 BCA ¶ 15,785 at 78,162-63.

Where both parties move for summary judgment, we must evaluate each motion upon its own merits. *McKay v. United States*, 199 F.3d 1376, 1380 (Fed. Cir. 1999); *Mingus Constructors, Inc. v. United States*, 812 F.2d 1387, 1390 (Fed. Cir. 1987). We will grant a motion for summary judgment only when the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show there is no genuine issue as to any material fact and the moving party is entitled to entry of judgment as a matter of law. The burden of demonstrating these elements is on the party who seeks summary judgment and the non-moving party is entitled to have all reasonable inferences drawn in its favor. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-24 (1986); *Elekta Instrument S.A. v. O.U.R. Scientific Int'l, Inc.*, 214 F.3d 1302, 1306 (Fed. Cir. 2000).

A fact is material if it may affect the outcome, that is, the finding of the fact is relevant and necessary to the proceeding. A genuine dispute exists regarding a material fact if sufficient evidence is presented that a reasonable fact finder could decide the issue in favor of the non-moving party. *E.g., Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248-50 (1986); *Opryland USA, Inc. v. Great American Music Show, Inc.*, 970 F.2d 847, 849-50 (Fed. Cir. 1992). While the non-moving party need not present its entire case in response to a summary judgment motion, to defeat the motion, it must present sufficient evidence to show that an evidentiary conflict exists on the record as to the material fact at issue. *Armco, Inc. v. Cyclops Corp.*, 791 F.2d 147, 149 (Fed. Cir. 1986); *Barmag Barmer Maschinenfabrik AG v. Murata Machinery, Ltd.*, 731 F.2d 831, 835-36 (Fed. Cir. 1984).

I. Construction of FAR 31.205-52

The Government contends that FAR 31.205-52 is applicable to LIRIS's cost-reimbursement contract and limits the recovery of "amortization, cost of money and depreciation costs" under the contract to the amount of those costs allowable prior to occurrence of the business combination at issue, *i.e*., Honeywell's 1989 sale of EOD to LIRIS. The Government asserts that: FAR 31.205-52, ASSET VALUATIONS RESULTING FROM BUSINESS COMBINATIONS, became effective 23 July 1990; LIRIS received its contract two months later during September 1990; its contract contained FAR 52.216-7, ALLOWABLE COST AND PAYMENT (APR 1984), providing that the cost principles in effect at time of contract award are controlling regarding cost allowability; and therefore FAR 31.205-52 applies to costs claimed under the contract. The Government further asserts that: LIRIS's purchase of EOD constituted a "business combination" under APB 16; the "language of FAR 31.205-52 is clear on its face," that is, when the "purchase method" is utilized to account for a business combination, "**increased** amortization, cost of money, and depreciation costs resulting from a business combination are unallowable"; LIRIS utilized the "purchase," rather than "pooling of interests," method to account for its EOD business combination; and, since FAR 31.205-52 "is conditional only upon use of the purchase method of accounting," we should sustain the ACO's final decision which disallowed LIRIS's claimed increased costs with respect to amortization, cost of money, and depreciation arising from the business combination. (Gov't SJM at 7-10 (emphasis in original))

LIRIS does not dispute that: FAR 31.205-52 became effective in July 1990; it obtained its contract two months later in September 1990; and its contract contained FAR 52.216-7 providing the cost principles in effect at time of contract award are controlling. Additionally, LIRIS does not dispute that purchase of EOD was a "business combination" under APB 16 or that it utilized the "purchase method" to account for its EOD business combination. (*E.g*., app. SJM at 7, 8, 56)

LIRIS, however, disagrees with the Government's assertion that the language of FAR 31.205-52 is "plain" (app. opp. at 15). It contends that the FAR cost principle "is ambiguous" and that the Government's "interpretation of [the FAR's] plain meaning is unacceptably expansive and improper" (app. supp. opp. at 22).

LIRIS asserts it construed the FAR as applying "only to business combinations which would occur after the promulgation of the cost principle" and, since its "use of the purchase method of accounting for business combinations predated the promulgation of FAR 31.205-52," "the instant contract did not preclude it from charging amortization, cost of money and depreciation consistent with the purchase method of accounting" (app. opp. at 7, 15; app. SJM at 53, 56, 95-96; app. supp. opp. at 5, 7, 22; app. supp. br. at 6). LIRIS and *amicus* argue:

> [T]he plain meaning of the cost principle would . . . suggest that it applies to business combinations that take place <u>after</u> the provision is effective since it references situations "when the purchase method of accounting for a business combination is used." The reference to "is" clearly does not suggest application to past events, but rather to events that take place while the cost principle is in effect.

(App. SJM at 96 (emphasis in original); *amicus* br. at 2)

The threshold issue presented for resolution, therefore, is whether FAR 31.205-52 is "ambiguous," *i.e*., has more than one reasonable interpretation. *See, e.g*., *PCA Health Plans of Texas, Inc. v. LaChance*, 191 F.3d 1353, 1355 (Fed. Cir. 1999); *Massie v. United States*, 166 F.3d 1184, 1189 (Fed. Cir. 1999); FAR 31.103(b) (CO shall incorporate cost principles by reference in contracts with commercial organizations as bases for determining reimbursable costs under cost-reimbursement contracts). Interpretation of a regulation is a question of law. *See, e.g*., *Perry v. Martin Marietta Corp*., 47 F.3d 1134, 1137 (Fed. Cir. 1995); *Riverside Research Institute v. United States*, 860 F.2d 420, 422 (Fed. Cir. 1988). The threshold issue presented is thus appropriate for resolution by summary judgment motion.

An agency's interpretation of its regulations normally is entitled to considerable deference. *E.g., Udall v. Tallman*, 380 U.S. 1, 16-17 (1965). Here, however, deference is not required because the FAR is not a regulation of the DoD. *Perry v. Martin Marietta Corp*., 47 F.3d at 1137; *Newport News Shipbuilding & Dry Dock v. Garrett*, 6 F.3d 1547, 1551 (Fed. Cir. 1993) (FAR is part of a comprehensive Federal procurement system); 48 C.F.R. § 1.102(b) (1984) (FAR is prescribed jointly by Secretary of Defense, Administrator of the General Services Administration, and Administrator of the National Aeronautics and Space Administration).

In construing a regulation, we first look at its "plain language." *PCA Health Plans of Texas, Inc. v. LaChance*, 191 F.3d at 1355; *Lockheed Corp. v. Widnall*, 113 F.3d 1225, 1227 (Fed. Cir. 1997). We consider the terms of the regulation in accordance with their common meaning. *E.g., Ingalls Shipbuilding, Inc. v. Dalton*, 119 F.3d 972, 976 (Fed. Cir. 1997).

FAR 31.205-52 provides:

> *When the purchase method of accounting for a business combination is used*, allowable amortization, cost of money and depreciation shall be limited to the total of the amounts that would have been allowed had the combination not taken place.

48 C.F.R. § 32.205-52 (1990) (emphasis added). LIRIS correctly notes the FAR contains the word "is," rather than the words "was" or "has been," and the word "is" constitutes the "present tense" of the verb "be." Thus, as LIRIS asserts, the regulation can fairly be construed as providing that it applies to use of the "purchase method of accounting for a business combination" after the effective date of the FAR. *See, e.g., Wiener v. Eastern Arkansas Planting Co*., 975 F.2d 1350, 1355 (8th Cir. 1992); *Reuther v. Trustees of the Trucking Employees of Passaic and Bergen Co. Welfare Fund*, 575 F.2d 1074, 1077 (3d Cir. 1978). Neither FAR 32.205-52, nor any other FAR, however, includes a definition of the phrase "purchase method of accounting" or "business combination." Moreover, these two phrases do not appear in standard dictionaries. *E.g*., WEBSTER'S II NEW RIVERSIDE UNIV. DICTIONARY 212, 955 (1988). Accordingly, in order to ascertain whether there was use of the "purchase method of accounting for a business combination" after the FAR's effective date, we examine the CAS, which deal with similar subjects, for potential guidance. *See Perry v. Martin Marietta Corp*., 47 F.3d at 1137 (where FAR implements CAS, one should examine any guidance the CASB has published to aid in interpretation); *accord Rice v. Martin Marietta Corp*., 13 F.3d 1563, 1568 (Fed. Cir. 1993) (regulations dealing with similar subjects are to be interpreted harmoniously); *General Elec. Co. v. United States*, 929 F.2d 679, 681 (Fed. Cir. 1991) (same).

The CAS also do not include definitions of the phrases "purchase method of accounting" or "business combination." CAS 404, however, utilizes both the phrases "'purchase method' of accounting for business combinations" and "'pooling of interest method' of accounting for business combinations," which are set forth in APB 16. 48 C.F.R. § 30.404-50(d) and (e) (1990). In their briefs, LIRIS and the Government both assert that the language of CAS 404 derives from APB 16. (*E.g*., Gov't SJM at 8-9 (APB 16 defines a "business combination" and "purchase method of accounting"); app. SJM at 11 (APB 16 deemed "widely accepted and well defined practice for accounting for assets in business combinations”), 60-61 (current accounting codification governing use of purchase method of accounting recognized by CAS is set forth in APB 16))

We agree with the parties that the regulations include “terms of art” or “technical terms” which require reference to APB 16, a widely-accepted opinion which was issued by the accounting community. *See Gould Defense Systems, Inc.*, ASBCA No. 24881, 83-2 BCA ¶ 16,676 at 82,979 (use of the purchase method under CAS 404 requires reference to APB 16). We ordinarily look to the meaning of a regulatory term at the time that the regulation was adopted. *See, e.g*., *MCI Telecomms. Corp. v. AT&T Co.*, 512 U.S. 218, 227-28 (1994) (explaining “most relevant time for determining a statutory term’s meaning” is time when statute became law); *General Dynamics Corp*., ASBCA No. 31359, 92-1 ¶ 24,698 at 123,255 (for interpretation purposes, regulations treated no differently than statutes and same rules of construction apply). Here, it is undisputed that, before the CAS and FAR were issued, APB 16 set forth the accounting community’s view of “business combinations” and the accounting methods to be utilized for such combinations – “pooling of interests” and “purchase” (*e.g*., Gov’t SJM at 4; app. SJM at 7). *Compare Gould Defense Systems, Inc.*, *supra*, at 82,971 (the CASB is charged with familiarity with an APB opinion — most important financial accounting pronouncement concerning appropriate accounting methodology — in existence at time of promulgation of CAS) *with Mass. v. Blackstone Valley Elec. Co.*, 67 F.3d 981, 986 (1st Cir. 1995) (no “plain meaning” of term “cyanides” apparent where scientific community has failed to speak in single authoritative voice regarding the term). Utilization of quotation marks around the phrases “purchase method” and “pooling of interest method” in the earlier promulgated CAS, and the lack of any definition of those phrases in either the CAS or FAR indicate that the CASB was treating those phrases as established technical terms or terms of art. *See, e.g*., *Corning Glass Works v. Brennan*, 417 U.S. 188, 201-02 (1974). When a regulation contains “technical words or terms of art,” as here, “‘it [is] proper to explain them by reference to the art or science to which they [are] appropriate.’” *Id*. at 201 (alterations in original) *quoting Greenleaf v. Goodrich*, 101 U.S. (11 Otto) 278, 284 (1880); *Shell Petroleum, Inc. v. United States*, 182 F.3d 212, 217 (3d Cir. 1999).

APB 16 provides, with respect to the purchase method of accounting, that an acquiring corporation records at its cost the assets acquired less liabilities assumed and thereafter the reported income of the acquiring corporation “includes the operations of the acquired company *after acquisition*, based on the cost to the acquiring corporation” (Gov’t SJM ex. 2 at ¶¶ 11, 21 (emphasis added)). APB 16 states that “an acquiring corporation accounts for the economic substance of the transaction . . . by recording: . . . [e]xpenses and net income *after an acquisition* computed [up]on the bargained cost of acquired assets less assumed liabilities, not on the costs to a previous owner.” (*Id*. at ¶ 21 (emphasis added)). Thus, the purchase method of accounting does not comprise simply a “step-up” in values of the assets acquired, *i.e*., recording at cost of the acquired assets less liabilities assumed. Rather, it includes, *after acquisition,* the reporting of the acquiring corporation’s income utilizing operations of the acquired company based on cost to the acquiring corporation. (*Compare id*. at ¶¶ 11, 21 *with id*. at ¶¶ 12, 52 (under pooling of interests method, former bases of accounting are retained)). An acquiring corporation, accordingly, continues to utilize the "purchase method of accounting" after it has "stepped-up" the values of the assets it acquired in a business combination.

LIRIS's construction of the FAR 31.205-52 phrase — "when the purchase method of accounting for a business combination is used" — as referencing solely the event of "step-up" of acquired asset values, which occurs at time of acquisition/business combination, therefore, is not reasonable. The technical words (or term of art) "purchase method of accounting" plainly also refer to LIRIS's reporting of income, *after the EOD acquisition/business combination,* utilizing the operations of EOD based upon cost to LIRIS. Both the Government and LIRIS, a sophisticated Government contractor, must construe technical words/terms of art in the CAS and FAR by reference to the appropriate art or science. *See, e.g*., *Corning Glass Works v. Brennan*, 417 U.S. at 201-02. Because the interpretation of the FAR advanced by LIRIS (and *amicus*) in this appeal ignores the accounting community's definition of the phrase "purchase method of accounting" for business combinations set forth in APB 16, it is unreasonable. Thus, we do not find FAR 31.205-52 ambiguous, *i.e*., susceptible to more than one reasonable interpretation. *See, McAbee Constr., Inc. v. United* States, 97 F.3d 1431, 1435 (Fed. Cir. 1996); *Gibbs v. United States*, 358 F.2d 972, 980 (Ct. Cl. 1966). The ACO's final decision correctly concluded that, under the plain language of FAR 31.205-52, when the "purchase method of accounting for a business combination is used" by LIRIS to report income utilizing the operations of EOD based upon the cost of EOD to LIRIS, allowable amortization, cost of money and depreciation must be limited to the total of the amounts that would have been allowed had the combination not taken place.[1]

II. <u>ACO Final Decision</u>

LIRIS contends the ACO did not reach his final decision independently, but was directed to issue the decision. LIRIS argues that, in reaching his final decision, the ACO "considered the guidance issued by both DCAA Headquarters and DCMC headquarters," and "simply adopted the DCAA and DLA-dictated conclusions, without question." LIRIS adds that the ACO did not undertake a review or analysis of whether LIRIS's "method of calculating step-up . . . would have permitted some of the claimed costs to be allowable" and "[t]he fact that [LIRIS] had identified the costs as step-up related [in its invoice] does not vitiate the need for [the Government] to evaluate the particularities of those costs and, only thereafter, be empowered to recommend or determine their allowability." According to LIRIS, because the ACO believed for over a year that FAR 31.205-52 did not apply to the LIRIS-EOD business combination and offered no explanation for the change in his opinion, other than a subsequent review of FAR 52.216-7, which it deemed an incredible explanation by an ACO with "long experience in Government contract administration," this Board should infer the ACO "simply accepted DCAA and DLA dictation, despite the determination of his independent judgment to the contrary." (*E.g*., app. SJM opp. at 8; app. supp. reply at 2-3, 9-18)

The Government contends the "independence of the ACO's final decision is *immaterial* to the issue of whether the ACO properly applied FAR 31.205-52." It argues that LIRIS "spent considerable effort asserting" this Board possesses jurisdiction and, "[i]f the decision was not independently made, the Board lacks jurisdiction and the claim must be remanded for an independent final decision." With respect to the analysis to be performed, the Government adds that the ACO "owes no duty to a contractor to audit its proposal to determine whether an amount, which the contractor identified as relating 'solely' to an unallowable category, might somehow have an allowable amount within it." (Gov't reply at 3-4 (emphasis in original))

Under the Contract Disputes Act of 1978, our review of a CO's decision is *de novo*. We accord no presumptive effect to a CO's decision. *E.g., Wilner v. United States*, 24 F.3d 1397, 1402-03 (Fed. Cir. 1994) (*en banc*). Existence of *de novo* review by a board of contract appeals, however, has been held not to obviate the need for "a proper and conscientious first decision" by a CO. *N.Y. Shipbuilding Corp. v. United States*, 385 F.2d 427, 435 (Ct. Cl. 1967).

The level of discretion which must be exercised by a CO in issuing a final decision is a question of law. *See, e.g*., *McDonnell Douglas Corp. v. United States*, 182 F.3d 1319, 1325 (Fed. Cir. 1999), *cert. denied*, 529 U.S. 1097 (2000); *Darwin Constr. Co. v. United States*, 811 F.2d 593, 596 (Fed. Cir. 1987). The established rule is that a CO must fully consider the issue before him and make up his own mind regarding the issue; not that a CO isolate himself and refuse to obtain guidance and advice from others. *E.g*., *J.A. Terteling & Sons, Inc. v. United States*, 390 F.2d 926, 927 (Ct. Cl. 1968); *Jacob Schlesinger, Inc. v. United States*, 94 Ct. Cl. 289, 307 (1941).

Courts have held that: a contractor is entitled to a finding by the contractually agreed officer; a decision by someone else is a nullity; and, if a contractor does not receive a finding by the contractually agreed officer, a tribunal can act as if, prior to commencing suit, the contractor received no determination of its claims under the Disputes clause of the parties' contract. *E.g*., *New York Shipbuilding Corp. v. United States*, 385 F.2d at 436. It is well-established, however, that the fact a CO has accepted the views of advisors does not mean that the decision was not his own. *Pacific Architects & Eng'rs, Inc. v. United States*, 491 F.2d 734, 744-46 (Ct. Cl. 1974); *Max Jordan Bauunternehmung v. United States*, 10 Cl. Ct. 672, 680 (1986), *aff'd*, 820 F.2d 1208 (Fed. Cir. 1987).

The Disputes clause requirement for a decision by a CO on all disputes arising under or relating to a contract, FAR 33.215, does not bar a CO from obtaining advice from others. A CO may, for the purpose of forming his or her independent judgment, obtain information and advice from advisors and staff offices, particularly in the fields of accounting, engineering and law, areas in which he or she may have little or no expertise. Indeed, it would reflect poor judgment on the part of a CO if he or she did not do so. *Pacific Architects & Eng'rs, Inc.*, 491 F.2d at 744; *Container Sys. Corp., Inc.*, ASBCA No. 40611, 94-1 BCA ¶ 26,354 at 131,092; *Max Jordan Bauunternehmung*, ASBCA No. 23055, 82-1 BCA ¶ 15,685 at 77,574-76, *aff'd*, 10 Cl. Ct. 672 (1986) (Wunderlich Act review), *aff'd*, 820 F.2d 1208 (Fed. Cir. 1987); *Barringer & Botke*, IBCA No. 428-3-4, 65-1 BCA ¶ 4797 at 22,775.

High-level concern regarding the issue presented does not demonstrate that the ACO lost his independent judgment. *See, e.g., McDonnell Douglas Corp. v. United States*, 182 F.3d at 1323-24, 1328-29. The issue presented is deemed by LIRIS and the Government to be one of first impression, *i.e.*, a test case, and therefore an issue meriting such concern.

That the ACO did not undertake a review or analysis of LIRIS's claimed costs, "evaluate the particularities of those costs," and ascertain whether LIRIS's method of calculating step-up permitted some of those claimed costs to be allowable all similarly fail to demonstrate that the ACO lost his independent judgment. The ACO did not attempt to independently verify the facts because LIRIS, the one providing the facts, had first-hand knowledge of those facts. No requirement exists that an ACO independently investigate the facts of a claim. *E.g., Prism Constr. Co*., ASBCA Nos. 44682, *et al*., 97-1 BCA ¶ 28,909 at 144,125.

Accordingly, as a matter of law, we have no basis to conclude that the ACO failed to independently reach his final decision because he received advice regarding LIRIS's invoice from DCAA, his headquarters, or others. The record here shows that the ACO's action disallowing LIRIS's claimed costs was not pretextual or unrelated to obligations under the parties' contract. *See, e.g., McDonnell Douglas*, 182 F.3d at 1326, 1329.

LIRIS asserts that inferences should be drawn from the ACO's change in opinion regarding the applicability of FAR 31.205-52. An ACO, however, is free to change his preliminary view after receipt of advice from others. That the ACO accepted advice he received from an advisor does not, by itself, require a conclusion that the ACO failed to independently exercise his judgment. *Nuclear Research Corp. v. United States*, 814 F.2d 647, 650 (Fed. Cir. 1987); *Space Age Engineering, Inc.*, ASBCA Nos. 25761, *et al*., 86-1 BCA ¶ 18,611 at 93,451; *Introl Corp*., ASBCA No. 27610, 85-2 BCA ¶ 18,044 at 90,578; *Prestex, Inc.*, ASBCA No. 22552, 81-2 BCA ¶ 15,193 at 75,232-33, *aff'd*, 3 Cl. Ct. 373 (1983).

While LIRIS suggests in its briefs that there should be further proceedings to determine whether the ACO actually devoted his personal and independent consideration to the decision bearing his name, all that LIRIS has shown is the ACO received advice from others and changed his preliminary view regarding applicability of the FAR after receipt of that advice. As discussed above, that showing is insufficient, as a matter of law, to overcome the presumption of regularity given to actions of Government officials. It simply is not an adequate showing to call for further inquiry into the issue of whether the ACO put his own mind to the problem and rendered his own decision. *See, e.g., J.A. Terteling & Sons*, 390 F.2d at 927; *Siebe North, Inc., and Norton Co*., ASBCA No. 34366, 89-1 BCA ¶ 21,487 at 108,243; *Space Age Engineering*, *supra*, 86-1 BCA at 93,452; *see also*, *Anderson v. Liberty Lobby*, 477 U.S. at 248-52 (party must present sufficient evidence showing an evidentiary conflict exists upon the record as to material fact); *Celotex Corp. v. Catrett*, 477 U.S. at 323 (there can be no genuine issue as to material fact where there is a complete failure of proof concerning an essential element of nonmoving party's case). In sum, there is not sufficient evidence in this appeal showing an evidentiary conflict regarding whether the ACO "put his own mind to the problem" and rendered his own decision. Thus, there is no basis to act as if the ACO's final decision is a "nullity."[2]

III. Taking of Property

LIRIS contends that application of FAR 31.205-52 to a business combination which occurred before the effective date of that regulation constitutes a "taking" of property, contrary to the Fifth Amendment to the Constitution. LIRIS asserts that, "[t]o insist, as did the Final Decision . . . , that FAR 31.205-52 precludes recognition of the step-up in the depreciable value of assets acquired prior to its promulgation, results in appropriating those assets in the hands of a new [corporate] owner into uncompensated Government service." LIRIS adds that the Government can "seek to ease the burden of its contracting costs," but it "cannot do so by pressing private property into public service without [the payment of just] compensation." According to LIRIS, whether viewed through the lens of the Supreme Court's *per se* takings jurisprudence, *see, e.g., Loretto v. Teleprompter Manhattan CATV Corp*., 458 U.S. 419 (1982), or analyzed as a regulatory taking, *see, e.g*., *Connolly v. Pension Benefit Guar. Corp*., 475 U.S. 211, 224 (1986), FAR 31.205-52 violates the Takings Clause when it is applied to the costs of assets acquired in business combinations which occurred prior to the effective date of that cost principle. (App. SJM at 56, 95-104; app. opp. at 9; app. supp. opp. at 22; app. supp. br. at 10-13)

Amicus curiae similarly contends that application of FAR 31.205-52 constitutes a "taking" of property, contrary to the Fifth Amendment to the Constitution. It argues that "'over regulation' which imposes conditions that are unrelated to and have no logical nexus to property rights and obligations affected are 'unconstitutional conditions' and effect a taking." *Amicus* asserts that the FAR comprises "over regulation" because the Government's "interest" here is to purchase goods on an equal footing with any private purchaser, and there is no nexus between this interest and FAR 31.205-52. According to *amicus*, the FAR results in the Government not reimbursing contractors for costs incurred using assets to perform Government contracts and only furthers a Government interest in "keeping its coffers full at the expense of government contractors." (*Amicus* br. at 2-8)

The Government contends that the final decision's application of FAR 31.205-52 "does not constitute an unconstitutional taking." The Government asserts that LIRIS and *amicus* can "show no distinct investment backed expectations sufficient to support a finding of a taking." The Government states:

> [LIRIS] voluntarily entered into a contract that made costs reimbursable in accordance with the FAR 31.2 cost principles in effect on the date of contract award. Several of the cost principles in effect on the date of this contract make admittedly incurred costs (e.g., Interest FAR 31.205-20) unallowable, even though such costs would normally be recouped under normal commercial pricing practices. But these are the terms under which government contracts are awarded, and no one is forced to bid or make offers on such contracts.

Citing *Yankee Atomic Elec. Co. v. United States*, 112 F.3d 1569 (Fed. Cir. 1997), *cert. denied*, 524 U.S. 951 (1998), the Government adds that LIRIS has "made no showing of [any] prior contracts containing an unmistakable promise that the FAR Part 31.2 cost principles would not change, especially for *future* contracts" (emphasis in original). (Gov't reply at 27-29; Gov't supp. br. at 12-13)

While LIRIS asserts that "[i]t is clear that th[is] Board has the authority to consider a Takings Clause challenge to the enforceability of a particular contractual term" (app. SJM at 95 n.32 *citing Westinghouse Elec. Corp*., ASBCA No. 25787, 85-1 BCA ¶ 17,910 at 89,696, *aff'd*, 782 F.2d 1017 (Fed. Cir. 1986)), it is settled that we lack jurisdiction to entertain a claim founded upon the Takings Clause of the Fifth Amendment of the Constitution. *E.g., M&M Services, Inc.*, ASBCA No. 28712, 84-2 BCA ¶ 17,405 at 86,688 (complaint count which seeks award on basis of improper "taking" in violation of Fifth Amendment dismissed for lack of jurisdiction). Under the Tucker Act, 28 U.S.C. §§ 1346(a)(2), 1491, jurisdiction to render judgment upon claims founded on the Takings Clause is given only to the courts. *United Technologies Corp., Pratt & Whitney Group*, ASBCA Nos. 46880, *et al*., 95-1 BCA ¶ 27,456 at 136,770; *Norcoast Constructors, Inc. & Morrison-Knudsen Co, Inc., J.V.*, ASBCA No. 12751, 72-2 BCA ¶ 9699 at 45,284. We explained several years ago that:

> Boards of contract appeals have no Tucker Act jurisdiction. The [Contract Disputes Act, 41 U.S.C. §§ 601-13,] did not authorize agency boards to grant relief founded upon the Constitution. The boards have jurisdiction only where and to the extent the Government has waived sovereign immunity, and any waiver of sovereign immunity "cannot be implied but must be unequivocally expressed." *Overall Roofing & Const. Inc. v. United States*, 929 F.2d 687, 688 (Fed. Cir. 1991); *see also*

> *Fidelity Const. Co. v. United States*, 700 F.2d 1379, 1387 (Fed. Cir. 1983), *cert. denied*, 464 U.S. 82 (1983). [Citation parentheticals omitted.]

United Technologies Corp., supra, 95-1 BCA at 136,770.

Our *Westinghouse* decision cited by LIRIS does not hold otherwise. In that appeal, we simply stated the contractor's assertions regarding the "taking" effect of the regulation do not comport with the facts of the appeal. 85-1 BCA at 89,695-96. We explained that "neither appellant nor any other defense contractor has a property right to any form of contract financing." *Id*. at 89,696. While we noted in *dicta* that the regulation at issue reduces the amount of financing available to some contractors through progress payments and that it "does not constitute a Fifth Amendment 'taking' of property" because "the Government, as creditor, is free to set the terms under which it will provide financing," the issue of jurisdiction over a Fifth Amendment taking claim does not appear to have been raised and clearly was not addressed. *Id*. Accordingly, we lack authority to entertain LIRIS's assertions regarding a taking of its property without just compensation and express no views regarding the merits of any such claim.

IV. Validity of FAR 31.205-52

LIRIS and *amicus* make various assertions, which challenge the "validity" of FAR 31.205-52. For example, LIRIS contends the regulation "does not satisfy the requirement of due process," is "inherently unconstitutional," and is not valid "under the arbitrary and capricious standard" of the Administrative Procedure Act (APA). (App. SJM at 55, 72, 78) Since we lack authority to furnish relief based solely upon alleged violations of the Constitution, *e.g*., *M&M Services, Inc.*, ASBCA No. 28712, 84-2 BCA ¶ 17,405 at 86,688, we usually do not possess jurisdiction to address claims concerning the Due Process Clause. *Silangan Manpower Services,* ASBCA No. 35304, 88-2 BCA ¶ 20,554 at 103,909; *The Swanson Group, Inc.*, ASBCA No. 47677, 96-2 BCA ¶ 28,565 at 142,603 n. Moreover, since most of our appeals proceed under the Contract Disputes Act of 1978, 41 U.S.C. §§ 601-13, the procedures of the APA generally are not of concern to us. *E.g., McQuiston Assocs*., ASBCA No. 24676, 83-2 BCA ¶ 16,602 at 82,549. In this appeal, however, we are authorized to and must address the constitutional and APA issues that LIRIS and *amicus* raise. The claim for money presented to us is not founded upon the APA or Constitution. Rather, it is founded upon a Government contract. LIRIS asserts that its "contract" with the Government entitles it to be reimbursed for depreciation and FCCM expense incurred. The Government does not dispute that this is true, but asserts that a part of the depreciation and FCCM expense (*i.e*., that part arising from the EOD business combination write-up of asset values) cannot be reimbursed because those costs are not "allowable" costs pursuant to FAR 31.205-52. In response to the Government's assertion, LIRIS argues that the FAR relied upon is invalid for several reasons relating to the Due Process Clause and APA, and therefore it is entitled to be reimbursed for those costs. An unconstitutional enactment may be found void *ab initio*, *Norton v. Shelby County*, 118 U.S. 425, 438-39 (1886), and may not be given effect. *E.g*., *Younger v. Harris*, 401 U.S. 37, 52 (1971). In addition, a regulation subject to the APA cannot be afforded the "force and effect of law" if not promulgated pursuant to the statutory procedural minimum found in that Act." *Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979); *accord G.L. Christian & Assocs. v. United States*, 320 F.2d 345, 350 (Ct. Cl. 1963), *cert. denied*, 375 U.S. 954 (1963) (to have "force and effect of law," regulation cannot be inconsistent with any statute). LIRIS accordingly presents a claim for money presently due under a contract. Issues regarding the validity of the FAR arise here only incidentally, necessitating an answer by us in the course of our construing the parties' contract to determine whether payment is indeed owing to LIRIS. *See, e.g., Alabama Hosp. Assoc. v. United States*, 656 F.2d 606, 609-10 (Ct. Cl. 1981), *cert. denied*, 456 U.S. 943 (1982); *Gentry v. United States*, 546 F.2d 343, 346 (Ct. Cl. 1976). Based upon these circumstances, we possess jurisdiction over and must address the constitutional and APA challenges to the validity of FAR 31.205-52 presented. *See Westinghouse Elec. Corp.*, ASBCA No. 25787, 85-1 BCA ¶ 17,910 at 89,696, *aff'd*, 782 F.2d 1017 (Fed. Cir. 1986) (due process clause challenge to validity of progress payment regulation); *Boeing Co*., ASBCA No. 11866, 69-1 BCA ¶ 7898 at 36,744, 36,749-50, *aff'd*, 480 F.2d 854 (Ct. Cl. 1973); *see also Newport News Shipbuilding & Dry Dock v. Garrett*, 6 F.3d 1547, 1551-52 (Fed. Cir. 1986) (challenge to FAR as conflicting with CDA); *United States v. Grumman Aerospace Corp.*, 927 F.2d 575, 578-79 (Fed. Cir.), *cert. denied*, 502 U.S. 919 (1991) (same).[3]

A. Sham Notice and Comment Procedures

LIRIS contends that, in promulgating FAR 31.205-52, the CPC did not adhere to notice and comment procedures set forth in the APA, 5 U.S.C. § 553, and that when the Government fails to satisfy APA notice and comment procedures, its regulation will be invalidated. LIRIS asserts that, while APA "notice and comment procedures . . . 'oblige [an agency] to consider the comments it received and to articulate a reasoned explanation for its decision,'" in promulgating the cost principle, the CPC "completely disregarded" "all public comments from industry," gave "responses to industry comments . . . so superficial as to not meet the standards established for judicial review," and furnished a rationale "so unsupported and illusory as to constitute no rationale at all." LIRIS adds that: with respect to FAR 31.205-52, a "sham process was used by the drafters of the regulation"; the Government can not treat its procedural obligations under the APA as "meaningless ritual"; and the FAR, therefore, should "be struck down." (App. SJM at 55-56, 69-70, 72-73, 82-85, *citing Williams Natural Gas Co. v. FERC*, 872 F.2d 438, 450 (D.C. Cir. 1989); app. supp. br. at 7, 9 (emphasis and bracketed material in original))

The Government contends that "FAR 31.205-52 was lawfully promulgated." The Government asserts its promulgation of the FAR was exempt from "notice and comment" procedures under the APA because Congress intended that, where "the Government is in the position of an individual citizen and is concerned with its own property, funds, or contracts," the procedures "not extend" to its activities. (Gov't reply at 29, *citing Parsons of California*, ASBCA No. 27635, 84-1 BCA ¶ 17,175 (concurring opinion), *quoting*, 92 CONG. REC. 5650 (1946)) The Government adds that, even if the APA procedures apply to promulgation of FAR 31.205-52, the FAR's "extensive regulatory history, outlining almost six years of deliberation, rebuts" LIRIS's assertion there was a "'sham' process." According to the Government, the "narrow" standard of review for such action is satisfied here by "the extensive record of deliberations and coordination with both the public and various governmental bodies." (Gov't reply at 30-36)

The notice and comment procedures of the APA are not of concern to us. The CPC, DAR Council and CAAC were not required to follow APA notice and comment procedures in issuing the FAR. *Essex Electro Eng'rs, Inc. v. United States*, 960 F.2d 1576, 1581 (Fed. Cir. 1992), *cert. denied*, 506 U.S. 953 (1992). The APA expressly exempts from its application "a matter relating to . . . public property, loans, grants, benefits, or *contracts*." 5 U.S.C. § 553(a)(2) (emphasis added). Thus, any Government failure to comport with the APA notice and comment procedures cannot, as a matter of law, serve as a basis for this Board to "strike down" or invalidate FAR 31.205-52. *See Essex Electro Eng'rs, Inc. v. United States*, 960 F.2d at 1581; *Rio Hondo Mem'l Hosp. v. United States*, 689 F.2d 1025, 1033-34 (Ct. Cl. 1982); *St. Francis Mem'l Hosp. v. United States*, 648 F.2d 1305, 1308 (Ct. Cl. 1981); *see also Good Samaritan Hosp. v. Mathews*, 609 F.2d 949, 953-54 (9th Cir. 1979).

B. Arbitrary, Capricious, Abuse of
Discretion And Not In Accord With Law

As noted above, LIRIS additionally contends that the FAR should be "struck down" because it is "inherently unconstitutional and illegal" (app. SJM at 55). LIRIS argues that the FAR violates the Due Process Clause of the Fifth Amendment to the Constitution and the APA, 5 U.S.C. § 706(2)(A) (1988), because: (1) the CPC failed to formulate a rational approach to address the problem in promulgating the FAR; (2) the regulation treats a contractor in a business combination differently than one who acquires assets from a business simply disposing of assets; (3) the FAR is improperly retroactive altering legal consequences of events occurring before the regulation's promulgation; and (4) the FAR conflicts with other provisions of law, *i.e*., the CAS. (*E.g*., app. SJM at 78-79; *see, generally*, app. SJM at 55-94; app. supp. br. at 7-10)

Amicus similarly contends that the FAR cost principle contravenes the APA and, implicitly, the Due Process Clause. Citing the reasoning set forth in *Whitecliff, Inc. v. Shalala*, 20 F.3d 488 (D.C. Cir. 1994), and *Health Ins. Ass'n of America v. Shalala*, 23 F.3d 412 (D.C. Cir. 1994), *cert. denied*, 513 U.S. 1147 (1995), it argues that FAR 31.205-52 "conflicts with relevant procurement statutes that require contractors to be reimbursed for their costs" and was not "promulgated based on sound and supportable public policy concerns." (*Amicus* br. at 8-16)

The Government contends that FAR 31.205-52 comports with the Due Process Clause and the APA. It argues that the FAR: "was lawfully promulgated" by the CPC, which "acted rationally, if not perfectly, to address a well documented problem"; does not operate "retroactively," *i.e*., take away vested rights and impose a new disability on contractors; and is not in conflict with other provisions of law. (Gov't reply at 21-27, 30-39; Gov't supp. br. at 3-12)

The scope of our review of the validity of an administrative regulation such as this is necessarily limited. As long as a regulation is reasonable and not inconsistent with any constitutional or specific statutory provision, we have no basis upon which to overturn it. *Morgan v. OPM*, 773 F.2d 282, 287 (Fed. Cir. 1985); *Consumer Prod. Div., SCM Corp. v. Silver Reed America, Inc.*, 753 F.2d 1033, 1039 (Fed. Cir. 1985); *accord FCC v. Nat'l Citizens Committee for Broadcasting*, 436 U.S. 775 (1978). "Few principles of law are as well-settled as the proposition that regulations of a government agency must be upheld if in accord with law and not unreasonable." *Brown & Root Dev., Inc. v. TVA*, 681 F.2d 1313, 1316 (11th Cir. 1982), *citing Nat. Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472, 476 (1979), and *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 543-44 (1978); *accord Newport News Shipbuilding & Dry Dock Co. v. Garrett*, 6 F.3d 1547, 1551 (Fed. Cir. 1993); *Westinghouse Elec. Corp*., ASBCA No. 25787, 85-1 BCA ¶ 17,910 at 89,696, *aff'd*, 782 F.2d 1017 (Fed. Cir. 1986).

1. Lack of Rational Basis

In this context, the test of "reasonableness" is whether there is a rational basis for the regulation. *See Westinghouse Elec. Corp. v. United States*, 782 F.2d at 1021; *Morgan v. OPM*, 773 F.2d at 287; *St. Francis Mem'l Hosp. v. United States*, 648 F.2d 1305, 1307-08 (Ct. Cl. 1981). A regulation need not have a compelling basis to be sustained, only a rational one. *See Brown & Root*, 681 F.2d at 1316; *Jackson Park Hosp. Found. v. United States*, 659 F.2d 132, 137 (Ct. Cl. 1981); *Stevens Park Osteopathic Hosp., Inc. v. United States*, 633 F.2d 1373, 1383-85 (Ct. Cl. 1980); *accord United States v. Correll*, 389 U.S. 299, 307 (1967) (if found to "implement the Congressional mandate in some reasonable manner," regulation must be upheld).

To ascertain if a legitimate governmental goal exists for a regulation, we look to the "legislative intent" of the promulgators of the rule. We therefore examine the reports, comments, and recommendations issued by the regulation's promulgators. *Westinghouse Elec. Corp., supra*, 85-1 BCA at 89,698; *see Stevens Park Osteopathic Hosp.*, 633 F.2d at 1382-83; *Lincoln Park Nursing Home v. United States*, 220 Ct. Cl. 626, 629-30 (1979).

Here, as discussed above, the CPC issued a detailed report which analyzed the two methods of accounting for business combinations set forth in APB 16 and found that, under the purchase method, an asset revaluation could significantly change the recorded cost structure of a company upon which the pricing of Government contracts frequently is based. The CPC stated that the issue presented was the best method to ensure that both the Government and contractors were treated fairly in these uncommon, yet financially very significant events, given the peculiarity of Government procurement pricing using companies' recorded cost structures. The CPC surveyed the approaches taken to ensure equity when there is an asset revaluation arising from a business combination and found only two conceivable methods – (1) the recapture of excess depreciation on the sale of assets to another and (2) the non-recognition of depreciation and FCCM charges flowing from asset revaluations due to business combinations. The CPC stated that a dogmatic insistence that asset revaluations arising from business combinations be respected as "good accounting" leads to seeking equity through a depreciation recapture approach. The CPC, however, believed extension of a depreciation recapture approach to business combinations did not make sense and was not equitable. It explained that the approach was designed to deal with a very different set of circumstances, *i.e.*, frequent transfer of individual assets between independent, on-going companies where any particular asset disposition might "recapture" more or less depreciation at time of disposition than was actually borne in prior periods, but such variations would offset one another over time so that the outcome would be fair to both contractors and the Government. The CPC noted that, for this very reason, the depreciation recapture rule set forth in the cost principles (FAR 31.205-16(a)) and its restatement in the CAS (CAS 409.50(j)(3)) contemplate situations such as a mass disposition of assets where the recapture rule will not create equity and is to be abandoned in favor of case-by-case negotiation, and that every "business combination" is tantamount to a "mass disposition" of assets. The CPC concluded that, to ensure that what constitutes good accounting for business acquisitions does not create a situation that is unfair to the Government, the approach of simply not recognizing the depreciation and FCCM charges flowing from asset revaluation ought to be the basic Government rule.

The CPC elaborated upon its rationale for the rule in responding to comments on the proposed rule. The CPC stated it "does not believe that the cost accounting rules should encourage asset churning as a means of economic survival" and "rewarding the non-existent capital improvements represented by the [revaluation] bookkeeping of a business combination" had brought Government cost accounting to the "choking point." The CPC added that, if major defense work occurred in a real marketplace where factors other than cost determined price, prices to customers would not rise because a business combination had occurred, and Government contract prices should not be at the mercy of a circular process in which assets are sold for an amount in excess of their book value, creating higher book values and sale prices to Government customers. The CPC stated that the new rule is intended to "not" reward "that part of 'investment'" bringing no new capital assets to the job.

The goal of the CPC, therefore, was to ensure that what was deemed to constitute "good accounting practice" for businesses did not create a situation which was inequitable or unfair to the Government in event of occurrence of a business combination. The CPC wanted to make sure that, in the special circumstances of Government procurement where companies' recorded cost structures often are directly reflected in the prices charged to the Government, the Government was not at risk of paying higher prices simply because of a change in ownership of a supplier.

The CPC's concern regarding the Government being charged higher prices as a result of a business combination is not unwarranted. CAS 404, Capitalization of Tangible Assets, as in effect in 1990, essentially incorporates financial accounting practices for capitalization of assets. It prescribes a write-up or step-up of asset bases to fair value by an acquirer in a business combination. To "write-up" or "step-up" assets means to increase the book value of an acquired corporation's assets from their original book value to their "fair" value. *Gould Defense Sys., Inc.,* ASBCA No. 24881, 83-2 BCA ¶ 16,676 at 82,960. Thus, assets which are acquired in a merger subject to the purchase method of accounting are to be valued and capitalized at their acquisition cost. CAS 404.40(a), 404.50(d). Under CAS 409, the depreciable cost of a tangible capital asset is its capitalized cost less its estimated residual value. CAS 409.40(a)(1). Since an asset can be capitalized and depreciated only from its book value, to increase the book value of an asset is to increase the amount of depreciation that can be charged against it. *See id*. Moreover, because Appendix A of CAS 414 states that "facilities capital values used should be the same values that are used to generate depreciation," increasing book value of an asset for depreciation purposes also increases the amount of FCCM. *See* FAR 31.001 (facilities capital is the net book value of tangible capital assets and intangible assets subject to amortization); CAS 414.30(a)(3) (same); FAR 31.205-10 (FCCM is an imputed cost determined by applying a cost of money rate to facilities capital); *Raytheon Co.,* ASBCA No. 32419, 88-3 BCA ¶ 20,899 at 105,659; *Gould Defense Sys., supra*, 83-2 BCA at 82,973-74. Depreciation costs and FCCM are factors in a contractor's "indirect rates" charged the Government and direct costs. *See, e.g.,* CAS 409.40(b)(1)-(3), 414.50(c)(1); *Times Fiber Communications, Inc. and Times Microwave Sys., Inc.*, ASBCA No. 37301, 91-2 BCA ¶ 24,013 at 120,212, 120,219; *Raytheon Co.,* ASBCA No. 32419, 88-3 BCA ¶ 20,899. A contractor's costs, therefore, clearly increase when it steps-up or writes-up its asset values under the purchase method of accounting.

The CPC's additional concern that a contractor charging the Government higher prices as a result of a business-combination asset write-up creates a situation which is unfair or inequitable to the Government is one of long standing. The Government has maintained historically that it should be placed in no worse a position by a change in business ownership than it would have been in had the change not taken place. *E.g*., *ITT Gilfillan, Inc. v. United States*, 471 F.2d 1382, 1386 (Ct. Cl. 1973); *LTV Aerospace Corp. v. United States*, 425 F.2d 1237 (Ct. Cl. 1970). This concern has been reflected for years in both the language of the cost principle regarding ORGANIZATION COSTS (FAR 31.205-27(a)) and the language of the Government's standard novation agreement (FAR 42.1204(e)). Indeed, pursuant to the language of the standard novation agreement, courts and administrative boards have repeatedly held costs resulting from a write-up of assets after the acquisition of a contractor are not recoverable by a successor in interest because the costs could not be recovered by the original contractor. *Marquardt Co. v. United States*, 822 F.2d 1573, 1577 and n.5 (Fed. Cir. 1987); *see, e.g., LTV Aerospace Corp. v. United States*, 425 F.2d 1237 (Ct. Cl. 1970); *Sundstrand Turbo v. United States,* 389 F.2d 406, 412 (Ct. Cl. 1968). Moreover, concern that a contractor charging higher prices as a result of a business-combination asset write-up creates a situation which is unfair or inequitable to the Government resulted in promulgation of the cost principle disallowing "goodwill," FAR 31.205-49. Under the purchase method of accounting, goodwill is created when the purchase price of the acquirer exceeds the values assigned to the acquired entity's identifiable net assets. *See, e.g., Gould Defense Sys., supra*, 83-2 BCA at 82,938. Like other intangible assets, goodwill recorded is charged off over time to operations as amortization expense. *See id*. at 82,933, 82,939, 82,971, 82,975; CAS 414.30. As discussed above, because the CPC believed that goodwill caused the Government to pay more for an item after a merger than before and that the fact accountants recognized a cost should not lead automatically to the conclusion the cost should be reimbursed, it issued a cost principle not allowing goodwill created by a business combination under the purchase method of accounting. Thus, concern that contractors charging the Government higher prices due simply to a business-combination asset step-up or write-up is unfair or inequitable clearly has a historical basis.

The CPC's concern that it is inequitable or unfair for contractors to charge higher prices simply as a result of a business-combination asset revaluation stems from the belief that, because Government procurement pricing uses companies' recorded cost structures, the Government reimburses costs of assets which are owned by companies that perform Government contracts and, to allow such a company to have the Government reimburse an increase in the valuation of its assets' costs when it is acquired by another in a business combination is to duplicate overhead costs charged to the Government. As the CPC said in response to comments upon the proposed rule, it believes "Government contract prices should not be at the mercy of a circular process in which assets are sold for an amount in excess of their book value, creating higher book values and sales prices to Government customers," since "[r]eal capital investment, from the Government's viewpoint, is that which brings new assets to the job."

The effect of FAR 31.205-52 is to limit the allowable contract costs to those amounts which would have been incurred had the business combination and resulting asset revaluation not taken place. Prior to promulgation of the FAR, contractors were permitted to use recomputed asset values resulting from mergers and acquisitions. *E.g., Times Fiber Communications, Inc. & Times Microwave Sys., Inc.*, ASBCA No. 37301, 91-2 BCA ¶ 24,013 at 120,222. In *Marquardt Co. v. United States*, 822 F.2d 1573, 1580 (Fed. Cir. 1987), the court of appeals stated that "avoidance of duplication in overhead costs charged to the Government" comprised a rational basis for the Government's action denying cost reimbursement associated with a step-up in asset values due to a business combination. The appeals court explained that, in denying the cost reimbursement, the Government is "exercising its responsibility to see to it that its contracting business is conducted efficiently." *Id*. Accordingly, the CPC, DAR Council, and CAAC, clearly possessed and set forth a rational basis for promulgation of FAR 31.205-52.[4] *See id*.

LIRIS asserts that FAR 31.205-52 is arbitrary and capricious because it conflicts with GAAP and "many basic requirements of the American accounting system" (*e.g*., app. SJM opp. at 20). *Amicus* similarly asserts that the FAR is arbitrary and capricious because the purchase method of accounting does not require the Government to pay twice for the same assets. According to *amicus*, "[d]ifferent assets" are involved since "the new owner capitalizes and depreciates the acquired assets based on acquisition cost and the length of benefit to the owner (i.e., service life)." (*Amicus* br. at 16) Existence of differing views regarding the method of reimbursement which is most appropriate, however, does not make the Government's selection of one of the reimbursement methods "arbitrary and capricious." The Executive's administrative judgment as to which of the methods most appropriately implements the principles of cost reimbursement is entitled to deference. *E.g., St. Francis Mem'l Hosp. v. United States*, 648 F.2d at 1308, *citing Gosman v. United States*, 573 F.2d 31, 41 (Ct. Cl. 1978). In determining whether a regulation is reasonable, we must give considerable deference to the expertise of the agency, the "masters of the subject." *E.g., Consumer Prod. Div., SCM Corp. v. Silver Reed America, Inc.*, 753 F.2d at 1039.

LIRIS further asserts that the FAR is arbitrary and capricious because the CPC ignored the depreciation recapture alternative and "inequities to Government contractors" required by a rule which does not allow acquiring contractors to obtain reimbursement of costs (app. SJM at 74-75). As noted above, however, the CPC considered and rejected the depreciation recapture alternative. The CPC believed that alternative was not suitable to accomplish its goal and remedy the perceived inequity. The Government's ability to recapture gain on assets disposed of in a one-time merger was correctly deemed doubtful. *See, e.g., Eaton Corp*., ASBCA No. 34355, 93-2 BCA ¶ 25,743, *aff'd*, 26 F.3d 140 (Fed. Cir. 1994). The alternative chosen by the CPC may possibly lead to inequities in some cases, but that is not a sufficient basis for a general overturning of a reasonable choice made by an agency. *E.g., Westinghouse Elec. Corp. v. United States*, 782 F.2d at 1021. The record reveals a rational basis for the FAR promulgators to have arrived at their postulated beliefs and that the FAR is reasonably related to accomplishment of a legitimate Government objective. Where a regulation represents a determination by an agency arising from the exercise of its economic judgment in an area committed to its expertise, as here, it must be upheld. *E.g., Summit Nursing Home, Inc. v. United States*, 572 F.2d 737, 741 (Ct. Cl. 1978). We cannot substitute our judgment for that of the CPC, DAR Council, and CAAC regarding determination of which requirement will best serve the Government purpose. *See, e.g., Morgan v. OPM*, 773 F.2d at 287; *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971).[5]

In sum, the Government perceived an unfairness and decided to correct that unfairness by issuance of the regulation. Under the limited standard of review applicable to this appeal, the FAR cannot be invalidated, but must be upheld as a fair and reasonable exercise of administrative authority. *See, e.g*., *Consumer Prod. Div., SCM Corp. v. Silver Reed America, Inc.*, 753 F.2d at 1040.

2. Unequal Treatment

LIRIS also attacks FAR 31.205-52 as arbitrary and capricious on the grounds that it draws a distinction between a contractor who acquires a package of assets from another business that is simply disposing of some assets and a contractor who acquires a package of assets in a business combination. LIRIS argues it is unfair for two such contractors to not be treated uniformly under the FAR. According to LIRIS, if "a contractor acquires a package of assets in a business combination using the purchase method of accounting, it is precluded from using its actual costs expensed in that acquisition to calculate the new basis of [its] assets," but "if it acquires exactly the same package of assets from a . . . business, which is simply disposing of those assets, so that no business combination takes place, the contractor may calculate the new basis of those assets by using its actual costs expended in their purchase." (App. SJM at 68)

The Fifth Amendment, unlike the Fourteenth Amendment, does not contain any explicit guarantee of equal protection. However, in *Bolling v. Sharpe*, 347 U.S. 497, 499-500 (1954), the Supreme Court held that the Fifth Amendment requires the Federal Government to uphold the same equal protection principles required of the states by the Fourteenth Amendment. *National Leased Housing Ass'n v. United States*, 24 Cl. Ct. 647, 655 (1991), *aff'd*, 105 F.2d 1423 (Fed. Cir. 1997); *accord Buckley v. Valeo*, 424 U.S. 1, 93 (1976) (equal protection analysis under Fifth Amendment is same as under Fourteenth Amendment).

The different treatment afforded by FAR 31.205-52, however, does not fall within the realm of "inherently suspect classifications." A contractor who acquires a package of assets in a business combination is not in a "suspect" class which is entitled to heightened protection, and there are no fundamental rights at stake. *See, e.g., Maher v. Roe*, 432 U.S. 464, 470-74 (1977); *United States v. Kras*, 409 U.S. 434, 444-46 (1973); *Weinberger v. Wiesenfeld*, 420 U.S. 636, 651-53 (1975); *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 376-77 (1973) (reasoning applies to regulations as well). Thus, the test to be applied here simply is whether the goal sought is legitimate and the classification is rationally related to achievement of that goal. *See, e.g., Richardson v. Belcher*, 404 U.S. 78, 81-82 (1971); *Morgan v. OPM*, 773 F.2d at 287.

As discussed above, there is a "legitimate" goal of ensuring that, in the event of a business combination, what constitutes "good accounting practice" for business does not create an "inequitable situation" for the Government, that is, the avoidance of duplication in overhead costs charged the Government. With respect to the sale of individual assets, depreciation recapture is available to the Government under other regulatory provisions to avoid creation of an inequitable situation, *i.e*., payment of duplicate overhead. *E.g*., CAS 409.50(j)(3); FAR 31.205-16(a). The distinction under FAR 31.205-52 between a contractor acquiring individual assets and a contractor acquiring assets via a business combination, therefore, is rationally related to achievement of the Government's goal. *See, e.g*., *Thorpe v. Housing Authority of the City of Durham*, 393 U.S. 268, 280-81 (1969). Because the Government distinction or classification bears a rational relationship to a legitimate Government purpose, it will not be invalidated, even if it results in some inequality. *Cleland v. Nat. College of Business*, 435 U.S. 213, 220-21 (1978); *Richardson v. Belcher*, 404 U.S. at 83-84. Accordingly, as a matter of law, there also is no "equal protection" violation which can serve as a basis for this Board to "strike down" or invalidate FAR 31.205-52.

3. Improper Retroactivity

LIRIS additionally attacks FAR 31.205-52 as void on the ground it is "improperly retroactive" altering legal consequences of events occurring before promulgation. LIRIS argues that the Government's application of the FAR to its business combination, which occurred more than six months prior to the July effective date of the FAR, "radically alters the legal effect of that business combination, compared with what would have been its legal effect under the prior rule." LIRIS asserts that, "under the new cost principle, a new disability would attach with respect to a completed transaction, thereby making the principle retroactive as applied to that completed transaction." (App. SJM at 56, 86-92; app. supp. br. at 9) LIRIS adds that:

> [The fact t]hat the contract between [it] and [the Government] was not entered into until after the new cost principle was in effect does not in any way change the retroactive operation of the cost principle . . . . At the time the contract was entered into, the cost for which recovery is sought had already been fully incurred . . . .

(App. SJM at 90)

The Government argues that its application of FAR 31.205-52 with respect to combinations effected before 23 July 1990 does not constitute a retroactive application of the cost principle. The Government asserts there is nothing retroactive about applying a cost principle to a contract that expressly incorporates that provision. The Government adds that there is nothing novel about making a cost unallowable when it arises from a transaction which occurred prior to the date of the cost principle and cites as an example FAR 31.205-49, which "makes unallowable 'any costs for amortization, expensing, write-off or write-down of goodwill . . . ' without regard to when the transaction giving rise to goodwill costs took place." (Gov't SJM at 9, 13-14; Gov't reply at 21-27; Gov't supp. br. at 3-12)

While retroactivity is not favored in the law, *e.g.*, *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988), it is not *per se* unlawful. *E.g.*, *SEC v. Chenery Corp.*, 332 U.S. 194, 200-03 (1947); *Pasadena Hosp. Ass'n, Ltd. v. United States*, 618 F.2d 728, 735 (Ct. Cl. 1980). For example, in reviewing cost reimbursement regulations under the Medicare program, the Court of Claims approved regulations with retroactive effects. *St. Francis Mem'l Hosp. v. United States*, 648 F.2d at 1309-12; *Lincoln Park Nursing Home v. United States*, 220 Ct. Cl. at 632-33; *Summit Nursing Home, Inc. v. United States*, 572 F.2d 737, 743-45 (Ct. Cl. 1978).

Retroactive provisions often serve entirely benign and legitimate purposes, whether to respond to emergencies, to correct mistakes, to prevent circumvention of a provision in the interval immediately preceding its promulgation, or simply to give comprehensive effect to a new law Congress considers salutary. *Landgraf v. USI Film Prods.*, 511 U.S. 244, 267-68 (1994). "Retroactive application of a regulation will not be declared unconstitutional unless after a balancing of the considerations on both sides it is determined that the regulation is unreasonable." *Summit Nursing Home*, 572 F.2d at 742-43; *accord SEC v. Chenery Corp.*, 332 U.S. at 203.

Deciding when a provision operates "retroactively" is not always a simple or mechanical task. *Landgraf v. USI Film Prods.*, 511 U.S. at 268-69. A provision is deemed retroactive or retrospective if it "changes the legal consequences of acts completed before its effective date." *E.g.*, *Miller v. Florida*, 482 U.S. 423, 430 (1987). It is often said that a provision is retroactive if it would impair rights a party possessed when the party acted, increase a party's liability for past conduct, or impose new duties regarding transactions already completed. *Landgraf v. USI Films*, 511 U.S. at 268-69 and n.23, 280; *accord* BLACK'S LAW DICTIONARY 1184 (5th ed. 1979); *Union Pacific R.R. Co. v. Laramie Stock Yards Co.*, 231 U.S. 190, 199 (1913). However, a legal provision does not operate "retroactively" simply because it is applied in a case arising from conduct antedating that provision's promulgation or because it upsets a party's expectations based upon prior law. Even prospective provisions may unsettle expectations and impose burdens on past conduct. As the Supreme Court noted in *Landgraf*, 511 U.S. at 269-70 n.24, a new property tax or zoning regulation may upset reasonable expectations that prompted a party to acquire property, and a new law banning gambling may harm a party who had begun to build a casino before the law's enactment or spent his life learning to count cards. *See, e.g.*, *Travenol Laboratories, Inc. v. United States*, 118 F.3d 749, 752-53 (Fed. Cir. 1997) (Act not "retroactive" when applied to goods which entered country before effective date, but which were liquidated after that date); *Godoy v. OPM*, 221 F.3d 1329, 1331 (Fed. Cir. 1997) (repeal of rule not applied retroactively where event required to trigger rule did not occur prior to repeal).

A tribunal therefore must ascertain if a provision attaches new legal consequences to events which were completed before its promulgation. A conclusion that a particular regulation operates retroactively comes at the end of a process of judgment concerning the nature and extent of the change in the law and the degree of connection between the operation of the new rule and a relevant past event. *Landgraf v. USI Films*, 511 U.S. at 268-70; *accord Travenol Laboratories*, 118 F.3d at 752; *Summit Nursing Home*, 572 F.2d at 742.

After examining the nature and extent of the change in the law and the degree of connection between the operation of the new rule and past events, we hold, as a matter of law, that FAR 31.205-52 does not operate "retroactively." As discussed above, it was not the LIRIS-EOD business combination, which occurred less than seven months before the effective date of the FAR, that caused the regulation to apply to the disallowed costs here. Rather, it was LIRIS's use of the purchase method of accounting to account for income and expenses after its contract was awarded. The Government thus is applying the cost reimbursement principles in effect under the contract at the time contract expenses are accounted for by the purchase method of accounting, not a new reimbursement principle to prior expenses. *See, e.g., Litton Sys., Inc. v. United States*, 449 F.2d 392, 401 (Ct. Cl. 1971) (Government could not disallow retroactively costs allocated under contracts which were entered into before the promulgation of new Government policy); *Westinghouse Elec. Corp. Defense Group*, ASBCA No. 22923, 79-2 BCA ¶ 13,972 (agency attempt to alter procedures for making progress payments under 27 contracts which were entered into before promulgation of procedures held to be a "change"). While the FAR requires reference to antecedent facts, *i.e.*, the value of the EOD assets prior to the business combination, a legal provision is "not made retroactive merely because it draws upon antecedent facts for its operation." *Landgraf v. USI Films*, 511 U.S. at 271 n.24; *Cox v. Hart*, 260 U.S. 427, 435 (1922); *see Reynolds v. United States*, 292 U.S. 443, 447-49 (1934); *Chicago & Alton R.R. Co. v. Tranbarger*, 238 U.S. 67, 71-73 (1915). In addition, contrary to LIRIS' suggestion, it does not possess a vested right to reimbursement of contract costs based upon the write-up or step-up of asset values. FAR 52.216-7 confers nothing more than an expectation that cost reimbursement will be made in accordance with the cost principles in effect at the time a contract is entered into by the parties. *See United States v. Boeing Co.*, 802 F.2d 1390, 1394 (Fed. Cir. 1986) (DoD possesses legal authority to make costs unallowable); 10 U.S.C. § 2324(a) (agency shall require that a covered contract provide where contractor submits a proposal for settlement of indirect costs incurred for any period after such costs have been accrued and the proposal includes the submission of cost which is unallowable because the cost violates a cost principle, the cost shall be disallowed); *Westinghouse Elec. Corp*., ASBCA No. 25787, 85-1 BCA ¶ 17,910 at 89,696 (Government is free to set terms under which it contracts).[6]

Our conclusion that the FAR does not operate "retroactively" is amply supported by precedent. In *Pasadena Hosp. Ass'n, Ltd v. United States*, 618 F.2d at 732, 735, a hospital seeking reimbursement of costs under the Medicare program contended that the application of a regulation disallowing “reasonable” rental expenses owed to a “related organization,” except for the related organization’s lower cost of ownership of the land and buildings, was impermissibly “retroactive.” The hospital argued that its lease was executed long before the Medicare Act, but the agency refused to reimburse it for its total rental expenses, divesting it of a previously held right. The Court of Claims, however, summarily rejected the hospital’s contention. The court stated the hospital “never had a right to be reimbursed for its rent so we fail to see how it could be ‘divested’ of such a right.” The court added that the regulation disallowing the rental expenses furthered Government objectives and that the related organization possessed the right to receive rental payments from the hospital under its lease, which the regulation did not disturb. *Id.* at 735. The court thus held, as we do in this appeal, “that there is no retroactive effect . . . at all.” *Id*. In *Regions Hosp. v. Shalala*, 522 U.S. 448 (1998), another hospital similarly contended that a regulation allowing the Government to reaudit its 1984 costs, which were used as a base to calculate its graduate medical education cost reimbursement under the Medicare program for future cost years, was an impermissible retroactive rule. The Supreme Court, however, like the Court of Claims, summarily rejected the hospital’s contention. The Court stated: the reaudit rule calls for application of cost reimbursement principles in effect at the time the costs were incurred; correct application of those principles, not application of any new cost principle is the rule’s objective; and the adjusted reasonable cost figures resulting from the reaudits were to be used solely to calculate reimbursements for still open future years. *Id*. at 456. The Court explained that a regulation “‘is not made retroactive merely because it draws upon antecedent facts for its operation.’” *Id*., *quoting Kaiser Aluminum & Chem. Corp. v. Bonjorno*, 494 U.S. 827, 855 (1990) (Scalia, J., concurring). The Court, therefore, also held, as we do, that the rule did not amount to an impermissibly retroactive regulation.

In sum, FAR 31.205-52 is not impermissibly retroactive. Accordingly, as a matter of law, there additionally is no violation of due process based upon “retroactivity” which could serve as a basis for this Board to “strike down” or invalidate the FAR.

4. <u>Conflict with Other Legal Provisions</u>

Finally, LIRIS attacks FAR 31.205-52 as invalid upon the ground that it conflicts with other legal provisions. LIRIS contends the FAR mandates a system of measuring costs which is completely contradictory to the 1990 measurement mandates of CAS 404.50(d), 409, and 414, even though the “legal mandate for measuring costs has been granted by statute to the CAS.” LIRIS asserts that, while (a) CAS 414 provides facilities capital values are to be the same values used for depreciation, (b) CAS 409 states depreciable cost of tangible capital assets shall be capitalized cost less estimated residual value, and (c) CAS 404 provides contractors shall account for a business combination by utilizing the purchase method of accounting, which requires step-up or write-up of asset values to “fair market value,” the Government mandates under FAR 31.205-52 that contractors use previous contractors’ asset values and depreciation methods reflecting techniques for the calculation of depreciation which are “‘attributable to costs accrued in and allocated to a prior year’” and which make their own costs "wholly irrelevant." According to LIRIS, the FAR specifies "that a separate measurement process be undertaken, on the basis of different books and records, and that the conclusions of this measurement process be used to determine how much depreciation is allocable to Government contracts," all "in the guise of [the Government] setting an allowability ceiling." (App. SJM at 57-69)

Amicus similarly attacks FAR 31.205-52 as invalid on the ground that it conflicts with other legal provisions. *Amicus* contends that the FAR contravenes "procurement statutes that require contractors be reimbursed for their costs." According to *amicus*, under procurement statutes, such as 10 U.S.C. § 2324(a), contractors are to recover costs that they, as contractors, incur, but the FAR requires recognition of costs that a wholly separate party incurred. (*Amicus* br. at 8-13)

The Government contends that FAR 31.205-52 does not conflict with the CAS. The Government argues that the introductory phrase of the FAR ("[w]hen the purchase method of accounting for a business combination is used") indicates that the allowability limitation set forth in FAR 31.205-52 "comes into play only *after* a contractor has used the purchase method of accounting" and a contractor therefore must "comply with (rather than deviate from) the purchase method prescribed in CAS 404.50(d)" before the FAR applies. (Gov't reply at 37 (emphasis in original)) According to the Government, FAR 31.205-52 "expressly contemplates that costs have been measured, allocated and assigned in accordance with CAS 404.50(d) and then places a limitation on the allowability of such costs." The Government adds that, because the FAR first requires an allocation in accordance with the CAS, it resembles the regulation in *Rice v. Martin Marietta Corp.*, 13 F.3d 1563 (Fed. Cir. 1993), found not to conflict with CAS, rather than the regulation in *United States v. Boeing Co.*, 802 F.2d 1390 (Fed. Cir. 1986), found to conflict with CAS. (Gov't reply at 37-39)

a. FAR 31.205-52 Does Not Conflict With Procurement Statutes Requiring Contractor Cost Reimbursement

If a FAR provision does not carry out the legislative intent of a statute underlying that provision, this Board will not enforce the provision. *E.g., Inter-Continental Equip., Inc.*, ASBCA No. 36807, 94-2 BCA ¶ 26,708 at 132,863; *R&B Bewachungsgesellschaft mbH*, ASBCA No. 42221, 92-1 BCA ¶ 24,752 at 123,493. LIRIS and *amicus* do not contend here that FAR 31.205-52 contravenes any statute authorizing its issuance. While *amicus* asserts that the FAR contravenes statutes requiring the Government to reimburse contractors for their reasonable costs and necessary and proper expenses, the regulation simply comprises a proper exercise of OFPP's power to define cost and expense. *See, e.g., Pasadena Hosp. Ass'n, Ltd. v. United States*, 618 F.2d at 734. OFPP is authorized by statute to "prescribe Government-wide procurement policies" to be implemented in "a single Government-wide procurement regulation," the FAR. 41 U.S.C. § 405(a); *see* 41 U.S.C. § 421(c) (DoD, NASA, and GSA "shall jointly issue and maintain . . . a single

Government-wide procurement regulation . . . ."); 48 C.F.R. § 1.102(b) (1989); *Newport News Shipbuilding & Dry Dock Co. v. Garrett*, 6 F.3d 1547, 1551 (Fed. Cir. 1993). The FAR defines the total cost of a contract as "the sum of the allowable direct and indirect costs allocable to the contract." FAR 31.201-1 (1989). The FAR then sets forth cost principles for determining what costs are "allowable" under cost-reimbursement contracts. Pursuant to the FAR, a cost's "allowability" is determined by considering its reasonableness, its allocability, its compliance with CAS or GAAP (if CAS is not applicable), and whether there are any limitations or exclusions set forth in either the FAR or the contract. FAR 31.201-2 (1990).

FAR 31.205-52 constitutes a cost limitation or exclusion set forth in the FAR. It expressly limits or excludes specified costs from being deemed allowable. It is well-established that the "allowability of costs is a procurement concept that 'remains the province of the procuring agencies.'" *United States v. Boeing Co*., 802 F.2d at 1394; *Emerson Elec. Co*., ASBCA No. 30090, 87-1 BCA ¶ 19,478 at 98,425. The fact that costs have been incurred, measured, and allocated in accordance with CAS does not prohibit agencies from limiting the allowability of those costs under their regulations. *United States v. Boeing*, 802 F.2d at 1394; *see Boeing Co. v. United States*, 480 F.2d 854, 862-64 (Ct. Cl. 1973); *Lockheed Aircraft Corp. v. United States*, 375 F.2d 786, 792 (Ct. Cl. 1967). Agencies have "authority to disallow types and amounts of properly allocated costs for various policy reasons." *Rice v. Martin Marietta Corp.*, 13 F.3d 1563, 1569 (Fed. Cir. 1993). The DoD, NASA, and GSA therefore clearly were authorized to issue a regulation such as FAR 31.205-52, limiting amortization, cost of money and depreciation to that which would have been allowed had the contractor's business combination not occurred. Thus, there is no conflict between FAR 31.205-52 and procurement statutes cited by *amicus* providing for contractor cost reimbursement which would allow us to not enforce the FAR.

b. <u>FAR 31.205-52 Does Not Conflict With CAS</u>

The CASB has authority to "make, promulgate, amend and rescind cost accounting standards and interpretations thereof designed to achieve uniformity and consistency in the cost accounting standards governing measurement, assignment and allocation of costs to contracts with the United States." 41 U.S.C. § 422 (1988). The standards promulgated by the CASB are mandatory for use by all Executive agencies and their contractors with respect to designated contracts. *Id*.; *General Elec. Co. v. United States*, 21 Cl. Ct. 72, 75 n.6 (1990), *aff'd*, 929 F.2d 679 (Fed. Cir. 1991); *see Westinghouse Elec. Corp. v. United States*, 782 F.2d at 1020.

Exercise of FAR regulatory authority, of course, cannot violate other binding regulatory authority, such as CAS. *E.g., Westinghouse Elec. Corp. v. United States*, 782 F.2d at 1020. We, therefore, also must determine whether FAR 31.205-52 contravenes CAS, as asserted by LIRIS.

The canon of statutory construction, *i.e*., where the text permits, statutes dealing with similar subjects should be interpreted harmoniously, applies equally to regulations. *General Elec. Co. v. United States*, 929 F.2d at 681. Thus, we are mindful in making our determination regarding existence of a conflict between the CAS and FAR, that we are to give preference to finding a reasonable interpretation of the regulations which does not create unnecessary conflict. *Id*. at 682.

The CAS is a series of accounting standards intended to achieve uniformity and consistency in measuring, assigning, and allocating costs to contracts with the Federal Government. *Rice v. Martin Marietta Corp*., 13 F.3d at 1565. As discussed above, CAS 409 and 414 specify, respectively, that the depreciable cost of a tangible asset shall be its capitalized cost less its estimated residual value and that the facilities capital values used should be the same values used to generate depreciation. 48 C.F.R. §§ 30.409-40(a)(1), 30.414 Appendix (1990). These two standards accordingly require reference to CAS 404, which establishes criteria for the "capitalization of tangible assets." *See* 48 C.F.R. § 30.404-40 (1990). CAS 404 specifies the "acquisition cost of tangible capital assets" shall be capitalized and then discusses the values which are to be assigned such assets under both the "purchase" and "pooling of interest" methods of accounting for business combinations. 48 C.F.R. § 30.404-50(d) & (e) (1990). Thus, contrary to the suggestion of LIRIS, CAS 404 does not mandate that contractors account for a business combination only by utilizing the "purchase method" of accounting. *Id*. Rather, CAS 404 expressly recognizes that a business combination may be accounted for under the "purchase" or "pooling of interest" methods. *Id*.

As discussed above, the Government promulgated FAR 31.205-52 to prevent it from paying costs of amortization or depreciation of contractor equipment more than once. Under the FAR, if a contractor utilizes the purchase method of accounting for a business combination, its "allowable" amortization, cost of money and depreciation is limited to the total of amounts that would have been allowed had the combination not taken place. Thus, as noted by the Government, FAR 31.205-52 applies only where a contractor has utilized, and complied with, the "purchase method" of accounting for a business combination. Contractors are free to measure the value of assets acquired in a business combination in accordance with the purchase method and assign the capitalized value of those costs to accounting periods as depreciation pursuant to CAS 404 and 409. For purposes of CAS, this constitutes an allocation of the costs. *See, e.g., Rice v. Martin Marietta Corp*., 13 F.3d at 1569. Nothing in FAR 31.205-52 precludes contractors from measuring and allocating their costs pursuant to CAS. *See, e.g.,* 48 C.F.R. § 30.302-1(c) (1990) (for purposes of CAS, the phrase "measurement of cost" encompasses "accounting methods and techniques used in defining the components of cost, determining the basis for cost measurement, and establishing criteria for use of alternative cost measurement techniques"). The FAR, therefore, does not prescribe an alternate method of measuring and allocating costs which brings it into direct conflict with the CAS. Rather, the FAR simply limits contractors from recovering from the Government part of the costs they measure and assign under the CAS if they use the purchase method to account for their business combination. *See, e.g*., FAR 31.205-46 (costs for travel incurred by contractor personnel are allowable provided they constitute a reasonable charge; costs shall be considered reasonable to the extent they do not exceed the maximum *per diem* rates in effect); FAR 31.205-6(p) (senior executive personal service compensation is allowable to the extent it does not exceed OFPP benchmark compensation).

"This distinction is illustrated by the steps for computing the costs associated with a contract (a final cost objective)," which clarify how the allocability provisions work with the allowability provisions. *Rice v. Martin Marietta Corp*., 13 F.3d at 1568. The court of appeals has summarized the steps for computing contract cost by stating:

> The steps for computing the total cost *allocated* to a contract are as follows:
> (1) allocate direct costs to the contract, including unallowable costs pursuant to CAS 405;
> (2) allocate indirect costs (including G&A) to the contract pursuant to CAS 410 and 418 . . . ; and
> (3) add the direct and indirect costs.
> To compute the total *allowable* costs associated with a contract, the following additional steps are necessary:
> (4) determine the unallowable direct costs pursuant to procurement agency policies;
> (5) determine the unallowable G&A costs . . . by multiplying the unallowable costs associated with that contract times the G&A allocation rates . . .; and
> (6) disallow the unallowable direct and unallowable G&A costs by subtracting those costs from the total contract cost.

Id. at 1568-69 (emphasis added). FAR 31.205-52 pertains to steps (4) through (6) concerning allowability, not steps (1) through (3) regarding "allocability." *See Rice v. Martin Marietta Corp*., 13 F.3d at 1568-70. The FAR does not present allocation issues because a contractor's FCCM and depreciation cost are allocable to all contractor work pursuant to CAS (steps (1) through (3) above), just as bad debts, advertising, and interest expense are allocable to all contractor work pursuant to CAS, but are not allowable. *See* FAR 31.205-1, 31.205-3, 31.205-20. It is well-established that costs may be assignable and allocable under CAS, but not allowable under the FAR. *E.g., United States v. Boeing Co*., 802 F.2d at 1394.

While LIRIS asserts that the FAR specifies "a separate measurement process be undertaken, on the basis of different books and records, and that the conclusions of this measurement process be used," in order to effect an "allowability" limitation on any cost measured by CAS, there must be some measurement, such as a percentage of cost. *E.g., United States v. Boeing Co*., 802 F.2d at 1394. Here, a contractor utilizing the purchase method to account for a business combination must subtract from depreciation and FCCM costs allocated pursuant to CAS the total of amounts that would have been allowed had the combination not taken place to determine the portion of depreciation and FCCM cost not "allowable" (see steps (4) through (6) above). FAR 31.205-52. This subtraction step does not require any depreciation or FCCM expense to be "remeasured" or "reassigned." The calculation for disallowing expense here requires the measurement of "unallowable" cost, but that measurement does not require "allocation" of expense. *See Rice v. Martin Marietta Corp*., 13 F.3d at 1569.

LIRIS also suggests that this appeal is governed by *United States v. Boeing Co*., 802 F.2d 1390 (Fed. Cir. 1986), rather than by *Rice v. Martin Marietta Corp*., 13 F.3d 1563 (Fed. Cir. 1993). However, LIRIS's reliance on the former decision is misplaced. In *Boeing*, there was an irreconcilable conflict between the cost principle and CAS 412 and 413. Moreover, the test of allowability established by the cost principle was based upon "policy considerations not entirely divorced from cost accounting considerations." *Emerson Elec. Co*., ASBCA No. 30090, 87-1 BCA ¶ 19,478 at 98,424-25. We found in the underlying *Boeing* appeal that CAS 412 and 413 required that unfunded supplemental executive retirement plan (SERP) expense "be assigned to the year in which such costs are incurred and allocated to intermediate and final cost objectives for that year and prohibit[ed the] assignment of such costs to any other year." *Boeing Co*., ASBCA No. 28342, 85-3 BCA ¶ 18,435 at 92,582, 92,602-03. When Boeing sought reimbursement of SERP costs accrued as costs of services performed by its employees for a specific cost year, however, the agency invoked a cost principle requiring that pay-as-you go pension costs "be deductible for Federal income tax purposes in the same year, which in effect required that [the cost] be paid or funded" as if the contractor was required to utilize cash basis accounting. *Id*. at 92,600, 92,605, 92,610. We held the cost principle conflicted with CAS 412 because the effect of the principle was to render the costs unallowable unless they were measured, assigned and allocated in accordance with the Internal Revenue Code (on a cash basis), rather than in accordance with CAS (on an accrual basis). *Id*. at 92,605-06. We stated allowability of the costs was not "based on policy considerations independent of the cost accounting considerations of proper assignment and allocation of costs." *Id*. at 92,606. The court of appeals affirmed. *United States v. Boeing Co*., 802 F.2d 1390. The court stated:

> The [cost principle] in effect provides that pension costs were "unallowable" unless measured, allocated and assigned among periods in a manner which conflicts with CAS 412. The [principle] is not a provision which makes costs allowable or unallowable *per se* based upon a rational procurement policy entirely divorced from cost principles. Rather, the [principle] makes the allowability of a cost *contingent* upon use of a cost

> measurement, allocation and assignment technique which conflicts with the requirements of CAS 412 and 413. Under the [principle], Boeing's SERP costs are only *allowable* if assigned to a period other than the period to which CAS 412 and 413 require they be assigned. Therefore, we hold that the [principle] is in fact an allocability provision which conflicts with CAS 412 also an allocability provision.

Id. at 1394 (emphasis in original). The court added that, to hold otherwise, would be "to sanction [an agency] exercising its procurement authority in an arbitrary and capricious manner by completely ignoring a particular cost accounting standard." *Id*. at 1395. As discussed above, the record in this appeal reveals a rational basis, relating to legitimate procurement policy considerations for promulgation of FAR 31.205-52. Moreover, there is no irreconcilable conflict between the FAR and the CAS. The FAR applies only if a contractor utilizes and complies with the "purchase method" of accounting prescribed by CAS, and limits a contractor only from receiving reimbursement under *Government* contracts for a part of the costs measured and assigned under CAS based upon a rational procurement policy concerning duplicate overhead reimbursement which is independent of cost accounting considerations of proper cost assignment and allocation. The FAR has no impact on the costs measured and assigned in accordance with the "purchase method" under CAS to a contractor's commercial contracts. *See United States v. Boeing Co*., 802 F.2d at 1394; *Emerson Elec. Co*., ASBCA No. 30090, 87-1 BCA ¶ 19,478 at 98,425; *General Elec. Co. v. United States*, 21 Cl. Ct. at 78.

c. The Dissent Misreads The Comments Of The OFPP CASB And Confuses Allowability With Allocability

The dissent indicates two reasons to conclude that there is a prohibited difference between FAR 31.205-52 and the CAS. The first reason appears to be the "administrative history" set forth in the dissent indicating the "regulators understood" they were dealing with alternative accounting solutions and "there was a conflict between" CAS and the cost principles which needed to be remedied. The regulators, however, cannot fairly be said to have "recognized" a "conflict" between CAS and the cost principles arising from alternative accounting approaches.

The dissent's statement that the new CAS Board "explicitly recognized" when it amended CAS 404 in 1996 (six years after promulgation of FAR 31.205-52) that there was a "conflict" between CAS and the cost principles comprises a selective reading of the CAS Board's comments. When the comments are read in their entirety and in context, they do not support a grant of summary judgment to LIRIS, as the dissent suggests.

In promulgating FAR 31.205-52, the Government was concerned with "increases" in asset values due to use of the purchase method of accounting for business combinations because companies were being sold for "greater" sums than their historical costs. The issue of use of the purchase method where a company was sold for a sum "less" than its historical cost does not appear to have been addressed in the Government's rule making process.

As promulgated, FAR 31.205-52 stated that, "[w]hen the purchase method of accounting for a business combination is used, allowable amortization, cost of money, and depreciation shall be limited to the total of the amounts that would have been allowed had the combination not taken place." The regulation, therefore, disallowed an increase in the amount of depreciation claimed arising from use of the purchase method of accounting with respect to a business combination, but did not address or restrict any decrease in the amount of depreciation due to use of the purchase method. Some contractors believed it unfair to use the "historical cost" when the purchase method resulted in an increase in asset values and to use the "purchase cost" when it resulted in a decrease in asset values and was lower than the "historical cost." This issue was not raised in this appeal, likely because the business combination at issue is a prime example of those that concerned the Government – one where there was a significant increase in asset values.

During 1994, in an "advance notice" of proposed rulemaking, *see generally*, 41 U.S.C. § 422(g)(1), the new OFPP CASB proposed amending CAS 404 to provide that, after a business combination, for Government contract costing purposes, tangible capital assets shall retain their net book value recognized prior to the combination provided the assets had previously generated costs chargeable to Federal Government contracts. 59 Fed. Reg. 26,774 (1994). The proposed CAS amendment, accordingly, unlike the FAR, specified that increases and decreases in asset values under the purchase method be treated alike with respect to business combinations, *i.e*., the assets would retain their net book value recognized previously in both instances if they had generated costs charged to Government contracts.

The CAS Board's "advance notice" was issued after receipt of comments upon a 1993 staff discussion paper, which contained questions dealing with the measurement of the gain or loss subsequent to a business combination, its allocation between Government and contractor, and the possible methods of recovery that the Government could employ in trying to recover its share of a gain or loss. *Id*. Among the comments received by the Board and set forth in the "advance notice" with respect to the advisability of retaining the original asset base after a business combination was that the Government "should be consistent in its application of cost accounting practices in this area." *Id*. at 26,776. The notice indicated several commenters had stated the "apparent conflict" between the CAS and FAR should be eliminated. According to the commenters, the Government should either allow revaluation of assets subsequent to business combinations and then deal with the resulting gain and loss issues or adopt practices based upon not revaluing assets and limiting both "gains and losses to historical costs." *Id*. at 26,776-77. The Board stated in response it believed the Government had a sound claim to benefits that may emerge as the tangible capital asset values increase in response to various market forces and conversely, "if the government is entitled to the benefits that may emerge as the asset values increase, it should also be prepared to bear the additional costs when the asset values are decreasing." *Id*. at 26,777; *accord id*. at 26,775.

The next year, in its notice of proposed rule making, the OFPP CASB stated that, among the comments received upon its "advance notice," was that the current FAR, "in effect, sanctions the use of 'historical cost or fair value, whichever is lower." 60 Fed. Reg. 12,725-26 (1995). The CAS Board thereafter noted:

> [T]he FAR 31.205-52 provisions . . . have been generally recognized as leading to inequitable consequences from the perspective of contractors. One commenter stated: " * * * the FAR provision not only suffers from implementation and transition problems, but as written is patently unfair by using historical costs when the purchase method indicates increased asset values and using the purchase cost when it is lower than the historical values. This allows the government to choose the method of accounting which is most cost beneficial to it." Given these circumstances, the Board cannot agree that "no action" is the proper course to follow in this instance.
>
> Comment: Several commenters discussed the need to solve the apparent conflict between the CAS allocability provisions and the Federal Acquisition Regulation (FAR) allowability provisions in this area. In particular, it was suggested the OFPP Administrator address any continuing conflict between the [CAS] and FAR 31.205-52 pursuant to the authority conferred on the Administrator by 41 U.S.C. [§] 422(j)(3).
>
> Response: The Board is aware of the apparent conflict between the provisions of CAS 9904.404 and FAR 31.205-52. Once the proposed amendment to CAS has been promulgated, the OFPP Administrator will determine whether any changes may be necessary in the FAR cost principles to make them *fully compatible with the amended CAS 9904.404* and 9904.409.

Id. at 12,726-27 (emphasis added); *accord* 61 Fed. Reg. 5,521 ("OFPP Administrator will determine whether any changes may be necessary in the FAR cost principles to make them fully compatible with *amended* CAS 9904.404 and 9904.409") (emphasis added).

After CAS Board promulgation of the amended CAS 9904.404 and 9904.409, the CAAC and DAR Council proposed amending FAR 31.205-52 to provide, if the purchase method is used, for tangible capital assets the allowable depreciation and FCCM shall be the amount measured and assigned in accordance with CAS 9904.404-50(d), if allocable, reasonable, and not otherwise unallowable. 62 Fed. Reg. 35,900 (1997). The CAAC and DAR Council stated:

> The current cost principles, in concert with GAAP, do not recognize asset write-ups, but do require assets to be written-down if the book value of acquired assets is reduced to be consistent with the purchase price of an acquired company. The Councils believe that the "no step-up, no step-down" approach of the proposed rule is more equitable to contractors with non-CAS covered contracts than retention of the current approach. In addition, the proposed [FAR] rule will avoid complications that could arise from differences in accounting between CAS covered and non-CAS covered contracts for companies that come in and out of being CAS covered.

Id. Accordingly, the CAS Board "comments" concerning an apparent "conflict" relate to the difference between FAR 31.205-52, as promulgated, and CAS 404, as *amended* in 1996, five years after the contract dispute arose here. At issue in this appeal is CAS 404 prior to amendment.[7]

Moreover, to the extent that the dissent suggests that the CPC believed CAS 404 and 409 were inconsistent with FAR 31.205-52, the CPC expressly stated that it did "not believe" the FAR "would constitute an 'impermissible conflict' between the CAS and the cost principles of the kind found by the courts in the Boeing . . . [pension] case" (app. SJM ex. 3 at 23). Of key importance is the language the dissent omits from its quotation of the CPC's 1989 memorandum:

> Proponents of these overly fine distinctions between "measurement of cost" and "allowability of cost" tend to forget that both operations have a common purpose; i.e. to set out what the Government will ultimately pay under a contract in a given area. Costs are not measured for the abstract purpose of measuring them. Ultimate recoupment is the goal and to get there both tests must be met. Something often ignored by those who overemphasize these formalities is that the cost principles already contain both measurement and allocability rules. The recently implemented rules which limit "allowability" of travel costs to the per diem limits abided by bureaucrats is a measurement rule. In cases where greater costs than those limits are incurred, the excess travel cost is properly booked and charged to contracts, but it is not paid by

the Government. Strong recognition of this broader concept of "allowability" is found in the following quote from the Boeing . . . [pension] Case . . . :

> Since the allowability of a cost remains the province of the procuring agencies, *the DoD may limit costs based upon rational procurement policies and not all costs are deemed reasonable just because they have been incurred and measured*, allocated and assigned in accordance with CAS requirements. *Hence, DoD has the legal authority* to make all pension costs unallowable if it chooses to do so, to make the costs of specific types of pension plans unallowable, *to put ceilings on the amount of costs which would be allowable*, or to otherwise limit the allowability of pension costs. *It also follows that, in order to effect an allowability limitation on any cost measured by CAS, a measurement* – such as some percentage of cost – *is required*.

(App. supp. R4, tab 113 at 5) (emphasis added; citation omitted) Finally, under the 1988 statutory amendments creating the OFPP CASB, Congress specifically directed that the OFPP Administrator, the Chairman of the new CASB, "shall ensure that no regulation or proposed regulation of an executive agency is inconsistent with a cost accounting standard promulgated or amended . . . by rescinding or denying the promulgation of any such inconsistent regulation or proposed regulation . . . ." Office of Federal Procurement Policy Act Amendments of 1988, Pub. L. No. 100-679, 1988 U.S.C.C.A.N. (102 Stat.) 4055, 4062. While this statutory authority, 41 U.S.C. § 422(j)(3), was specifically brought to the attention of the OFPP Administrator by defense contractor representatives with respect to FAR 31.205-52 prior to the 1990 promulgation of that regulation, *e.g*., *CAS Board To Review Proposed Rule Disallowing Costs of Stepped Up Assets*, 52 FED. CONT. REP. 439 (1989), and the OFPP Administrator promised careful review of that issue, *id*., he took no action to block promulgation of or rescind the FAR. The lack of action to block promulgation of the FAR and six-year failure to rescind the FAR, in the face of *express* congressional direction to take such action when a regulation is deemed "inconsistent with a cost accounting standard," demonstrates that the "administrative history" here clearly does *not* support the dissent's "conclusion" that the regulators recognized "there was a prohibited difference between FAR 31.205-52 and the CAS." Accordingly, there simply is no "history" of Government regulators recognizing there is a conflict between the CAS and the cost principles which needs to be remedied, as suggested by the dissent.[8]

The second reason the dissent sets forth for concluding that there is a "prohibited difference" between FAR 31.205-52 and the CAS is that, "if machinery is sold as part of a business combination, and the purchase method of accounting is used, a portion of the purchase price would not be assigned to the machinery for purposes of determining depreciation and [FCCM]." As explained above, however, contrary to the dissent's assertion, when machinery is sold as part of a business combination and the purchase method of accounting is used, a portion of the purchase price *is assigned* to the machinery for purposes of the measurement and allocation of costs (under steps one through three above). Contractors are free to measure the value of their acquired assets pursuant to CAS 404 and 409. The dissent's "true" complaint is that, to it, "doing so would appear to be purposeless" because the costs ultimately are not "allowable" for purposes of Government contracts under FAR 31.205-52. However, it is well-settled that the fact that costs have been incurred, measured, and allocated in accordance with CAS does not prohibit agencies from limiting the allowability of those costs under their own regulations. *E.g., United States v. Boeing*, 802 F.2d at 1394. As we explain above, agencies have "authority to disallow types and amounts of properly allocated costs for various policy reasons. *E.g., Rice v. Martin Marietta Corp.*, 13 F.3d at 1569.

In sum, whether a conflict exists between a cost principle and CAS is a question of law appropriate for resolution by summary judgment motion. *See Boeing Co*., ASBCA No. 28342, 85-3 BCA ¶ 18,435 at 92,599, 92,608. The development and operation of FAR 31.205-52 determines if it is an allowability or allocability provision. *General Elec. Co. v. United States*, 929 F.2d at 628. FAR 31.205-52 was developed to be, and operates as, an "allowability" provision, rather than an "allocability" provision. Thus, there is no conflict between the FAR and the CAS which would allow us to not enforce the FAR.

CONCLUSION

The Government's motion for summary judgment is granted. The appellant's motion for summary judgment is denied. The appeal is denied.

Dated: 29 June 2001

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

I concur

ALLAN F. ELMORE
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

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

I dissent in part and concur in result in part (See separate opinion)

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

NOTES

1 While we need not go beyond the language of the FAR because the regulation is clear, the regulatory history of the provision also supports our interpretation. *See, e.g., Aydin Corp. v. Widnall*, 61 F.3d 1571, 1579 (Fed. Cir. 1995) (the drafting of regulation serves as useful interpretation aid). As discussed above, in response to concerns expressed by two commentators about differing treatment for the sale of individual assets, the CPC stated "[t]he language proposed for 31.205-52 employs the presence of the purchase method of accounting in a business combination as its triggering mechanism" and "[t]hat method's source within accounting literature is APB No. 16." Moreover, in commenting upon the proposed FAR, counsel for *amicus* here specifically raised the issue of whether the FAR applied to business combinations occurring prior to the effective date of the regulation. Counsel stated that "the proposed [FAR] language overreaches because it would apply to business combinations consummated years ago but which still affect the cost of contracts" and "[t]hese combinations . . . were entered into based upon the allowability of the resulting costs." In response, the CPC stated industry commentators believe that the Government is only entitled to wipe away effects of the asset write-up

when the combination took place between contract signing and completion, but "[t]his quaint line of reasoning does not fit modern times in the defense" industry "where prices tend to be based upon costs." The CPC added that counsel's concern about retroactivity of the rule has merit if a merger occurs when an entity has little or no Government business, but that no refinement of the rule is necessary because there are not many contractors in this position.

2 The lack of evidence of any evidentiary conflict regarding whether the ACO "put his own mind to the problem" is not due to a lack of opportunity to obtain such evidence. LIRIS's counsel conducted the discovery they desired, including the conduct of a deposition of the ACO where they examined the ACO under oath about the independence of his final decision. Deposition excerpts set forth in the record show the ACO believed he was free to disagree with the advice he received and that he saw no reason to disagree with the advice because he believed it to be correct. In fact, the ACO expressly stated under oath during his deposition that he now believed the cost principle applied to the LIRIS-EOD business combination and he would not have issued a final decision disallowing the costs "if he didn't feel that way."

3 In two prior appeals, we reviewed the constitutionality of a "regulation" without discussing our authority and/or jurisdiction to do so. *Westinghouse Elec. Corp*., ASBCA No. 25787, 85-1 BCA ¶ 17,910 at 89,697-99, *aff'd*, 782 F.2d 1017 (Fed. Cir. 1986) (alleged violation of Fifth Amendment Due Process Clause); *Boeing Co*., ASBCA No. 11866, 69-1 BCA ¶ 7898 at 36,744, 36,749-50, *aff'd*, 480 F.2d 854 (Ct. Cl. 1973) (same). The earlier of these two appeals, however, expressly, declined to consider the constitutionality of a "statute," which was stated to "be reserved for examination by a judicial tribunal." *Id*. at 36,749-50. By discussing our authority/jurisdiction above and citing to *Gentry v. United States*, 546 F.2d 343 (Ct. Cl. 1977), a case involving a statute held to violate the Fifth Amendment Due Process Clause, we do not mean to state that we may consider the constitutionality of a statute. Rather, we set forth no views with respect to that issue, which is not before us. We note, in passing, that the "[a]djudication of the constitutionality of congressional enactments has generally been thought beyond the jurisdiction of administrative agencies." *Johnson v. Robison*, 415 U.S. 361, 368 (1974); *quoting Oestereich v. Selective Service Board*, 393 U.S. 233, 242 (1968) (Harlan, J., concurring in result); *accord Public Utilities Comm'n v. United States*, 355 U.S. 534, 475 (1958). However, if addressing a constitutional challenge to a statute is consistent with, rather than contrary to congressionally conferred agency authority to decide claims, the Court of Appeals for the Federal Circuit has stated it is fair to infer Congress did not intend to deny the agency authority to address constitutional issues and the agency may decide the claim presented to it. *Riggin v. Office of Senate Fair Employment Practices*, 61 F.3d 1563, 1569-70 (Fed. Cir. 1995), *cert. denied*, 516 U.S. 1072 (1996) (board was

authorized to address constitutionality of statute bearing directly on question board clearly had jurisdiction to decide); *accord Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 215 (1994) (Federal Mine Safety and Health Review Commission addresses due process claims); *NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490, 493 (1979) (NLRB addresses First Amendment objection to exercise of statutory authority).

4

When the FAR was initially being drafted in 1978, there was to have been a single FAR Council and FAR Secretariat, headed by OFPP. At that time, OFPP possessed authority to issue procurement regulations which were binding on other agencies. Office of Federal Procurement Policy Act of 1974, Pub. L. No. 93-400, §§ 3, 6(a), 1974 U.S.C.C.A.N. (88 Stat.) 903, 905. When Congress reauthorized OFPP in 1980, however, it took away OFPP's authority to issue such regulations. OFPP Act Amendments of 1979, Pub. L. No. 96-83, § 4, 1979 U.S.C.C.A.N. (93 Stat.) 648, 649-50. Due to this change, the National Aeronautics and Space Administration (NASA), General Services Administration (GSA) and DoD insisted that the FAR be administered by two councils – one chaired by GSA which includes 12 civilian agencies (CAAC) and one chaired by DoD which includes NASA (DAR Council). Sometimes, the councils are collectively referred to as the "FAR Councils." The Councils have various committees, such as the CPC, which assist them with their responsibilities. *See, generally*, FAR 1.201-1, 1.201-2; Defense FAR Supplement 201.201-1*; Proposed FAR Rule Disallows Costs Resulting From Business Combinations*, 51 FED. CONTRACTS REP. 785 (1989); *DAR Council to Undergo Full-Scale Review*, 41 FED. CONTRACTS REP. 95 (1984); *FAR Due Out Next Month; Agencies Writing Supplements*, 40 FED. CONTRACTS REP. 354 (1983).

The Councils are not authorized or created by statute. Rather, GSA, NASA and DoD entered into a "Memorandum of Agreement" specifying that: matters primarily involving defense acquisition should be submitted to the DAR Council; matters primarily involving civilian agency acquisition should be submitted to the CAAC; matters affecting defense and civilian acquisition equally should be sent to the FAR Secretariat which will then refer them to the cognizant Council for consideration; the Council which processes a FAR case will keep the other Council and Secretariat advised of the status of the case; the Council which provides "final concurrence" on a case will forward the approved coverage to the FAR Secretariat for publication; if the two Councils cannot agree on resolution of a case, the matter will be forwarded for resolution to the Deputy Under Secretary of Defense for Acquisition Management, Assistant Administrator for Procurement at NASA, and Assistant Administrator for Acquisition Policy at GSA; and, if an agreement is not reached within 30 days for reasons pertaining to substantive differences, the matter forwarded will be deemed to be a "disagreement" in accordance with Public Law No. 98-191, which amended section 6(b) of the OFPP Act in 1983 to make clear that the OFPP Administrator possesses authority to prescribe regulations where there is a failure to agree among the three agencies statutorily authorized to issue procurement regulations. *Memorandum of Agreement For Maintaining the FAR*, *Signed By DOD, GSA and NASA*, 41 FED. CONTRACTS REP. 577 (1983); 41 U.S.C. § 405(b) (1984); *see, generally*, S. Rep. No. 100-424, at 10-11 (1988), *reprinted in* 1988 U.S.C.C.A.N. 5687, 5696-97.

Because it wished to make clear that the OFPP Administrator may initiate procurement policy as well as respond to initiatives by the agencies, during 1988, Congress amended the OFPP Act to provide that the OFPP Administrator may also prescribe regulations where DoD, NASA and GSA "fail to issue Government-wide regulations . . . in a timely manner . . . ." 41 U.S.C. § 405(b) (1989); *see, generally*, S. Rep. No. 100-424, at 19-20 (1988), *reprinted in* 1988 U.S.C.C.A.N. 5687, 5696-97. Additionally, during 1988, Congress created a "FAR Council," which consists of the OFPP Administrator, who chairs the Council, and the heads of DoD, NASA and GSA (or their designees), to "manage, coordinate, control, and monitor the maintenance of, and issuance of and changes in" the FAR. 41 U.S.C. § 421(a), (b), (f) (1989). In creating a "FAR Council," Congress did not intend "to relieve the agencies of their primary responsibility for development and implementation of procurement regulations" or to increase the authority of the Administrator of OFPP beyond that granted in other sections of the OFPP Act, but to establish a structural mechanism whereby council members are "encouraged to work together." *See, generally*, S. Rep. No. 100-424, at 20 (1988), *reprinted in* 1988 U.S.C.C.A.N. 5687, 5706.

Thus, ordinarily, the FAR is issued jointly pursuant to the authority of DoD under chapters 4 and 137 of Title 10, United States Code, the authority of NASA under the National Aeronautics and Space Act of 1958 (42 U.S.C. § 2451, *et seq*.), and the authority of GSA under title III of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. § 251, *et seq*.), based upon action by the CAAC and DAR Council. 41 U.S.C. §§ 405(b), 405a, 421(c). Accordingly, while some commentators refer to the "FAR Council" as issuing or promulgating changes to the FAR, *e.g.*, Ishak Akyuz, *Analyzing the Current State of Contract Bundling: Bundling Into The Millenium*, 30 PUB. CONT. L. J. 123, 125 (2000); *Highlights*, 55 FED. CONT. REP. 25 (1991), when determining whether there is a rational basis for promulgating a change and/or addition to the FAR, we must examine the actions of the DAR Council and CAAC, which have primary responsibility for development of such changes and/or additions.

5 LIRIS additionally argues that the FAR is arbitrary and capricious because the CPC did not consider (1) difficulties which could be encountered by a contractor if it was unable to or for some legitimate reason did not maintain prior contractor records from before issuance of the FAR and (2) the amount the Government previously paid for the depreciation of the assets. According to LIRIS, it went through a business combination in 1954 for which it is incapable of ascertaining pre-acquisition asset values, and it is not proper to give the Government 100 percent of the depreciation previously charged for assets if the Government only reimbursed a contractor for 10 percent of that

depreciation or was not charged at all for such depreciation. (App. SJM at 73-75; app. opp. at 10-11) However, this appeal does not present a merger which occurred decades or years before issuance of the FAR. Rather, it involves a business combination which occurred eight months after the FAR was published for comment, 54 Fed. Reg. 18,634-65 (1989), and less than seven months before the FAR's effective date, 55 Fed. Reg. 25,522 (1990). Moreover, as noted above, this appeal does not involve a contractor who engaged in no or little Government contract work prior to a business combination, but a contractor (EOD) who performed Government contracts as more than 80 percent of its work. Thus, there is no need for us to address here the additional arguments LIRIS raises. *See, e.g*., *Westinghouse Elec. Corp.*, 782 F.2d at 1021-22.

6 As the Court of Claims did in *Pasadena Hosp*., 618 F.2d at 735, we note that in this appeal the contractor cannot even claim it had "legitimate expectations" which were defeated. FAR 31.205-52 was published as a proposed regulation in May of 1989, eight months before consummation of the EOD business combination. 54 Fed. Reg. 18,634-65. LIRIS, therefore, was on notice of the possibility that its allowable amortization, cost of money and depreciation would be limited to the total of the amounts that would have been allowed had the combination not taken place, and could not reasonably have expected it would be reimbursed for such costs. *See, e.g*., *Pasadena Hosp*., 618 F.2d at 735-36.

7 LIRIS suggests that the new CASB's later revision of CAS 404 demonstrates that a conflict existed between the FAR and CAS. However, the mere fact a revision occurred is not an admission a conflict existed. It is equally agreeable with the view that confusion existed which had to be cleared up. *See General Elec. Co. v. United States*, 21 Cl. Ct. at 79.

8 We note that the dissent suggests the 1988 OFPP amendments set forth a more liberal test for invalidating a cost principle, *i.e*., that a cost principle need not "conflict" with CAS, but simply "differ" from CAS in order to be invalidated by this Board, and at times appears to adopt this more liberal test. We are not aware of any part of the legislative history of the OFPP amendments, which supports the dissent's suggestion that Congress intended to alter the well-established rule that regulations which "conflict" with the CAS are invalid and authorize invalidation absent a "conflict." Moreover, since Congress expressly directed that the OFPP Administrator ensure "no regulation or proposed regulation of an executive agency is *inconsistent* with a cost accounting standard," 41 U.S.C. § 422(j)(3) (emphasis added), to accept the more-liberal invalidation test advanced for the first time by the dissent here, we would have to ignore Congress's express language in another part of the same provision promulgated the same date, contrary to the principles of statutory construction. *See, e.g*., *General Elec. Co. v. United States*, 929 F.2d at 681.

OPINION BY JUDGE THOMAS DISSENTING IN PART
AND CONCURRING IN RESULT IN PART

I dissent in part and would sustain the appeal insofar as it relates to tangible capital assets. I concur in the result in part without joining in the discussion insofar as the appeal relates to intangible capital assets.

I dissent in part because the CAS statute provides that costs which are subject to the cost accounting standards "shall not be subject to regulations that . . . differ from such standards with respect to the measurement, assignment and allocation of such costs" (41 U.S.C. § 422(j)(4)). Here the costs are depreciation and cost of money (COM) on tangible capital assets. The effect of the majority's decision is to subject those costs to a regulation (FAR 31.205-52) which differs from the standards with respect to the measurement of those costs.

Calculation of depreciation and COM depends in part upon the cost of the relevant tangible capital asset. Thus, the FAR defines depreciation as "a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical matter." (*See* FAR 31.205-11(a), *see also* FAR 31.205-10, referencing CAS 414 (COM))

As of September 1990, CAS 404 CAPITALIZATION OF TANGIBLE ASSETS and related standards provided that when the purchase method of accounting for a business combination is used, the cost of tangible capital assets, and hence depreciation and COM, shall be measured using that method. For example, if machinery is sold as part of a business combination, and the purchase method of accounting is used, a portion of the purchase price of the acquired company shall be assigned to the machinery for purposes of calculating depreciation and COM. Newly promulgated FAR 31.205-52, on the other hand, required, in the case of the sale of a business at a profit, that when the purchase method of accounting for a business combination is used, depreciation and COM, and, by inference, the cost of the relevant tangible capital asset, shall be limited to that which would have been allowed if the business combination had not taken place. For example, if machinery is sold as part of a business combination, and the purchase method of accounting is used, a portion of the purchase price would not be assigned to the machinery for purposes of determining depreciation and COM.

To me, FAR 31.205-52 obviously conflicts with CAS 404 and related provisions with respect to the measurement of depreciation and COM. Furthermore, the administrative history of FAR 31.205-52 and of the subsequent amendments to the CAS and FAR indicates that the regulators understood that the provisions as in effect in September 1990 conflicted.

I first reprise the regulatory provisions, the administrative history of FAR 31.205-52, the 1988 statutory provisions and the subsequent amendments to the CAS and FAR, and then turn to a discussion of the issues.

1. Regulatory Provisions At Time of Contract Award

As of September 1990, CAS 404.20 required "that, for purposes of cost measurement, contractors establish and adhere to policies with respect to capitalization of tangible assets which satisfy criteria set forth herein." CAS 404.40 stated the fundamental requirement that "[t]he acquisition cost of tangible capital assets shall be capitalized." CAS 404.50(a) stated that "[t]he cost to acquire a tangible capital asset includes the purchase price of the asset and costs necessary to prepare the asset for use." CAS 404.50(d) provided with reference to the cost of tangible capital assets acquired through business combinations:

> (d) Under the "purchase method" of accounting for business combinations, acquired tangible capital assets shall be assigned a portion of the cost of the acquired company, not to exceed their fair value at date of acquisition. Where the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess.

48 C.F.R. § 30.404-20, -40, -50(a), (d) (1990).

CAS 409 DEPRECIATION OF TANGIBLE CAPITAL ASSETS provided at 409.20 "criteria and guidance for assigning costs of tangible capital assets to cost accounting periods and for allocating such costs to cost objectives within such periods in an objective and consistent manner." CAS 409.40 stated the fundamental requirement that:

> (a) The depreciable cost of a tangible capital asset (or group of assets) shall be assigned to cost accounting periods in accordance with the following criteria:
>
> (1) The depreciable cost of a tangible capital asset shall be its capitalized cost less its estimated residual value.
>
> . . . .
>
> (4) The gain or loss which is recognized upon disposition of a tangible capital asset shall be assigned to the cost accounting period in which the disposition occurs.

Paragraph 409.50(j)(1) provided for recapture of depreciation upon the sale of an asset: "[g]ains and losses on disposition of tangible capital assets shall be considered as adjustments of depreciation costs previously recognized and shall be assigned to the cost accounting period in which disposition occurs except as provided in paragraphs (j)(2) and (3) of this subsection." Paragraph (j)(3) provided that "[t]he contracting parties may account for gains and losses arising from mass or extraordinary dispositions in a manner which will result in treatment equitable to all parties." 48 C.F.R. § 30.409-20, -40, -50(j) (1990).

CAS 414 COST OF MONEY AS AN ELEMENT OF THE COST OF FACILITIES CAPITAL established criteria for the measurement and allocation of the cost of capital committed to facilities as an element of contract cost. It stated that cost of money computations should use the same values that are used to generate depreciation or amortization. 48 C.F.R. § 30.414-20 and App. A, "Basis" (1990).

Also as of 29 September 1990, newly promulgated FAR 31.205-52 ASSET VALUATIONS RESULTING FROM BUSINESS COMBINATIONS provided:

> When the purchase method of accounting for a business combination is used, allowable amortization, cost of money and depreciation shall be limited to the total of the amounts that would have been allowed had the combination not taken place.

FAR 31.205-16(a) GAINS AND LOSSES ON DISPOSITION OF DEPRECIABLE PROPERTY OR CAPITAL ASSETS provided that "Gains and losses from the sale . . . of depreciable property shall be included in the year in which they occur . . . . However, no gain or loss shall be recognized as a result of the transfer of assets in a business combination (see 31.205-52)."

2. <u>Administrative History of FAR 31.205-52</u>

In 1987, the DAR Council's Commercial Cost Principles Committee (CPC) recommended changes to the cost principles relating to business combinations which ultimately resulted in the promulgation of FAR 31.205-52. The CPC reported in a memorandum to the DAR Council, "[b]y far the most important and contentious issue connected with the topic of business combinations is that of asset revaluation," which could result in duplicate charges. The CPC explained:

> [T]wo basic approaches to this issue through the cost principles are conceivable . . . . One is to recognize asset revaluations resulting from business acquisitions, thereby accepting altered depreciation and FCCM [COM] amounts in accounting periods subsequent to the acquisition. On this approach, equity is obtained for the Government by requiring that, in cases of

> upward revaluation, current Government contracts receive their fair share of the "recapture" of excess depreciation borne by previous contracts. The other approach is to simply not recognize for purposes of Government contract costing and pricing asset revaluations resulting from business combinations.

(Case 84-18 memorandum dated 4 Feb. 1987, app. supp. R4, tab 102 at 9, 19)

As the CPC recognized, CAS 404, 409 and 414 adopted the first basic approach. Thus, the memorandum stated that those standards:

> prescribe asset revaluation following a business acquisition in accordance with generally accepted accounting principles, and the calculation of depreciation expense and FCCM based upon such new valuations in subsequent accounting periods. The CAS also prescribes recognition of gains and losses on the disposition of individual assets, but does not explicitly address the situation in which it is the entire business that is disposed of.

(*Id*. at 15)

The CPC decided that the second basic approach would be preferable. It explained:

> In choosing between these two broad approaches, the Committee majority is persuaded that the fundamental issue here is one of how best to achieve fairness. Both the "depreciation recapture" and the "no recognition" approaches are, in the final analysis, nothing more than devices to ensure that what constitutes good accounting for business acquisitions does not create a situation that is "unfair" to the Government. In the opinion of the Committee, it is on this basis that the choice between these two approaches should be made.
>
> Measured by this standard, the Committee believes that the approach of simply not recognizing depreciation or FCCM charges flowing from asset revaluation ought to be the basic Government rule . . . .

(*Id.* at 19) While stating that it did not believe its recommendations impermissibly conflicted with the CAS, since the new cost principle coverage would "constitute an 'allowability' rule in the narrowest sense," the CPC recommended that the passages in CAS 404 and CAS 409 dealing with business combinations and depreciation recapture be deleted in the interest of avoiding "whatever litigative risk is inherent in letting the inconsistency stand" (*id*. at 23-24).

In 1989, following solicitation of comments on the proposed rule, the CPC stated that the contention that the proposed rule conflicted with the CAS had been advanced by several commentators:

> All of these commenters make the point that, in a business combination, CAS 404 and 409 require asset valuations, and the depreciation charges flowing from those valuations, to be based upon the purchase method of accounting . . . . They consider the proposed rule to be a measurement rule thinly disguised as an allowability rule and believe that such a rule cannot be made in the cost principles.
>
> <u>CPC Comments.</u>
>
> This issue is the crux of this case. The commenters are absolutely right as to what CAS and GAAP (which are in accord this time) require. While the CAS rules could be amended in a way that would achieve the desired equity, it does not seem likely that this will occur in the near future.
>
> The Government has two possible places to stand on this issue. The first is the position that the proposed rule is merely an "allowability" rule. This position maintains that the cost of a business combination transaction shall be accounted for and charged to contracts in the way that GAAP and CAS require, but the Government would only "allow" the level of cost that would have pertained had the combination not taken place. This argument carries the debate back in to the whole arbitrary, and not altogether logical, quagmire of the terms that define the jurisdictions of the CAS and the cost principles. Proponents of these overly fine distinctions between "measurement of cost" and "allowability of cost" tend to forget that both operations have a common purpose; i.e. to set out what the Government will ultimately pay under a contract in a given area . . . .
>
> . . . .
>
> The second argument available to the Government is that common sense dictates that there must be some way to remedy an inequity without waiting several years. Therefore, notwithstanding any future action by the CASB addressing the

> measurement of such costs, the Committee recommends the proposed cost principle to limit the allowability of such costs in order to address the immediate inequity.

(Case 88-146 memorandum dated 3 Oct. 1989, app. supp. R4, tab 113 at 4-5)

3. The CAS Statute as Enacted in 1988

In 1988, while the CPC was drafting FAR 31.205-52, the Congress re-established the CASB as an independent board within OFPP. The legislation provided that the CASB "shall have the exclusive authority to make, promulgate, amend, and rescind cost accounting standards and interpretations thereof designed to achieve uniformity and consistency in the cost accounting standards governing measurement, assignment, and allocation of costs to contracts with the United States." 41 U.S.C. § 422(f)(1). The legislation also provided that the cost accounting standards promulgated by the original CASB, such as CAS 404, 409 and 414, should remain in effect in the same manner as if promulgated by the re-established Board. 41 U.S.C. § 422(j)(1), (2). Finally, it stated that:

> (4) Costs which are the subject of cost accounting standards promulgated under this section shall not be subject to regulations that are established by another executive agency that differ from such standards with respect to the measurement, assignment, and allocation of such costs.

41 U.S.C. § 422(j)(4).

4. The 1996 Amendments to CAS 404 and 409

a. Text of the Amendments

Effective 15 April 1996, after a lengthy period of discussion and public commentary, the reconstituted CASB amended CAS 404.50(d) to conform it in relevant part to FAR 31.205-52:

> (d) The capitalized values of tangible capital assets acquired in a business combination, accounted for under the "purchase method" of accounting, shall be assigned to these assets as follows:
>
> (1) All the tangible capital assets of the acquired company that during the most recent cost accounting period prior to a business combination generated either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the

> basis of cost, shall be capitalized by the buyer at the net book value(s) of the asset(s) as reported by the seller at the time of the transaction.
>
> (2) All the tangible capital asset(s) of the acquired company that during the most recent cost accounting period prior to a business combination did not generate either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be assigned a portion of the cost of the acquired company not to exceed their fair value(s) at the date of acquisition. When the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess.

48 C.F.R. § 9904.404-50(d) (1996). The CASB also revised CAS 409 to reflect the amendment to CAS 404.50(d) (*see* paragraph 409-50(j)(5)).

b. Administrative History of the Amendments

On 8 March 1995, the CASB had issued a notice of proposed rulemaking (NPRM) with a draft of the 1996 amendments. 60 Fed. Reg. 12,725. In the NPRM, the Board summarized the various comments on a preliminary draft and the action taken by the Board in response to the comments. The summary recognized an apparent conflict between the CAS and the FAR:

> Comment: Several commenters discussed the need to solve the apparent conflict between the CAS allocability provisions and the . . . FAR . . . allowability provisions in this area. In particular, it was suggested the OFPP Administrator address any continuing conflict between the Cost Accounting Standards and FAR 31.205-52 pursuant to the authority conferred on the Administrator by 41 U.S.C. 422(j)(3).
>
> Response: The Board is aware of the apparent conflict between the provisions of CAS 9904.404 [CAS 404] and FAR 31.205-52. Once the proposed amendment to CAS has been promulgated, the OFPP Administrator will determine whether any changes may be necessary in the FAR cost principles to make them fully compatible with the amended CAS 9904.404 and 9904.409.

60 Fed. Reg. 12,727.

In the preamble to the amendments, the CASB noted that several commenters on the NPRM had "stressed once more that they believe there is a conflict between the CAS allocability provisions and the Federal Acquisition Regulation (FAR) allowability provisions in this area." The CASB repeated in its "response" that "[t]he Board is aware that there is an appearance of conflict between the provisions of CAS 9904.404 and FAR 31.205-52. As stated in the proposed rulemakings, the OFPP Administrator will determine whether any changes may be necessary in the FAR cost principles to make them fully compatible with amended CAS 9904.404 and 9904.409." 61 Fed. Reg. 5520, 5521 (Feb. 13, 1996).

5. <u>1998 Amendment to FAR 31.205-52</u>

In 1998, the FAR promulgators brought FAR 31.205-52 into line with CAS 404 and 409. Effective 24 April 1998, FAR 31.205-52 was revised to read:

> (a) For tangible capital assets, when the purchase method of accounting for a business combination is used, whether or not the contract or subcontract is subject to CAS, the allowable depreciation and cost of money shall be based on the capitalized asset values measured and assigned in accordance with 48 CFR 9904.404-50(d), if allocable, reasonable, and not otherwise unallowable.
>
> (b) For intangible capital assets, when the purchase method of accounting for a business combination is used, allowable amortization and cost of money shall be limited to the total of the amounts that would have been allowed had the combination not taken place.

63 Fed. Reg. 9067 (Feb. 23, 1998).

<u>DISCUSSION</u>

The CAS statute provides that costs which are subject to the cost accounting standards "shall not be subject to regulations that . . . differ from such standards with respect to the measurement, assignment and allocation of such costs" (41 U.S.C. § 422(j)(4)). Under the statute, where there is a conflict between the cost principles and the CAS on an issue of allocability, the CAS controls. *General Electric Co., Aerospace Group v. United States,* 21 Cl. Ct. 72, 75 and n.6 (1990), *aff'd on other grounds*, 929 F.2d 679 (Fed. Cir. 1991).

Whether a cost principle conflicts with the CAS turns upon "an inquiry into the true nature of the regulation." *General Electric Co., Aerospace Group*, 929 F.2d at 680. Two key cases interpreting whether there is a conflict between a particular cost principle and the CAS are *United States v. Boeing Co.*, 802 F.2d 1390 (Fed. Cir. 1986), and *Rice v. Martin Marietta Corp.*, 13 F.3d 1563 (Fed. Cir. 1993).[*] In *Boeing*, the Court concluded that a Defense Acquisition Regulation (DAR) cost principle providing that certain pension costs ("SERP" costs) were allowable only to the extent they were deductible for tax purposes in the same fiscal year conflicted with CAS 412 COMPOSITION AND MEASUREMENT OF PENSION COST and 413 ADJUSTMENT AND ALLOCATION OF PENSION COST. The Court first noted that:

> Since the allowability of a cost remains the province of the procuring agencies, the DOD may limit costs based upon rational procurement policies . . . . Hence, DOD has the legal authority to make all pension costs unallowable if it chooses to do so, to make the costs of specific types of pension plans unallowable, to put ceilings on the amount of costs which would be allowable, or to otherwise limit the allowability of pension costs. It also follows that, in order to effect an allowability limitation on any cost measured by CAS, a measurement—such as some percentage of cost—is required.

802 F.2d at 1394. The Court concluded that in the case before it, however, the DAR imposed "measurement by allocation and assignment requirements which [were] inconsistent" with those in CAS 412:

> . . . The DAR in effect provides that pension costs were "unallowable" unless measured, allocated and assigned among periods in a manner which conflicts with CAS 412. The DAR is not a provision which makes costs allowable or unallowable *per se* based upon a rational procurement policy entirely divorced from cost principles. Rather, the DAR makes the

[*] These cases, unlike the one before us, concern accounting practices for years prior to enactment of the 1988 statute. The most recent, *Rice*, concerned the years 1980-1985 (13 F.3d at 1565 n.1). Both *Boeing* and *Rice* relied for underlying authority upon an Armed Services Procurement Regulation (ASPR) subcommittee memorandum stating that "[s]hould there be a conflict with respect to allocability between the ASPR and the CAS, the former regulation will be superseded." *Boeing*, 802 F.2d at 1395; *Rice*, 13 F.3d at 1567 n.9. The Claims Court opinion in *General Electric Co*., *Aerospace Group* refers to the statute without discussing the difference in language. It is not clear, therefore, that these cases are controlling precedent on the issue of whether the cost principles "differ" from the CAS, possibly a lesser criterion for appellant to establish than "conflict." Since, in my view, the relevant regulations conflict, I do not address this point further.

> allowability of a cost *contingent* upon use of a cost measurement, allocation and assignment technique which conflicts with the requirements of CAS 412 and 413. Under the DAR, Boeing's SERP costs are only *allowable* if assigned to a period other than the period to which CAS 412 and 413 require they be assigned. Therefore, we hold that the DAR is in fact an allocability provision which conflicts with CAS 412 also an allocability provision.

Boeing, 802 F.2d at 1394.

In *Rice* on the other hand, the Court concluded that DAR 15-203(c) requiring that allowable and unallowable costs "bear their pro-rata share of the indirect costs" did not conflict with CAS 410 ALLOCATION OF BUSINESS UNIT GENERAL AND ADMINISTRATIVE EXPENSES TO FINAL COST OBJECTIVES. The Court explained:

> DAR 15-203(c) and CAS 410 operate upon G & A expenses in separate and distinct ways. CAS 410 provides criteria for the measurement and allocability of costs to contracts. The pertinent segment of DAR 15-203(c) establishes the allowability of the costs thus measured and allocated.

Rice, 13 F.3d at 1568. The Court illustrated this distinction by a summary of six steps for computing the costs associated with a contract, quoted *supra*, slip op. at 48.

Analyzing the case before us, under CAS 404.50(d), LIRIS was required to measure the cost of the former EOD tangible capital assets by assigning a portion of its cost to purchase EOD to them. Under CAS 409.40(a)(1), LIRIS was required to determine the amount of depreciation to be assigned to a particular cost accounting period based on the cost of the assets as measured pursuant to CAS 404. Under CAS 414, similar procedures were applicable to COM. Under FAR 31.205-52, on the other hand, LIRIS was required to limit depreciation and COM to that which would have been allowed had the combination not taken place. That is, LIRIS was required to determine the amount of depreciation and COM to be assigned to a particular cost accounting period based on the cost of the tangible capital assets as measured by Honeywell prior to the sale to LIRIS. The relevant costs recorded on Honeywell's books prior to the sale were less than, that is different from, those recorded on LIRIS's books pursuant to CAS 404.50(d).

Based on this analysis, the case is more akin to *Boeing* than to *Rice*. Through its limitation language, the FAR provided that in the case of the sale of a business at a profit, depreciation and COM costs were unallowable unless measured in a manner which conflicted with CAS 404.50(d). That is, under the FAR, depreciation and COM costs were to be measured as if the business combination had not taken place whereas under CAS 404.50(d) they were to be measured in accordance with the purchase method of accounting.

The FAR in effect crossed over the boundary from "allowability" issues to "allocability" issues. In this respect, FAR 31.205-52 differs from the legally authorized limitations referred to in *Boeing*, 802 F.2d at 1394, quoted above. FAR 31.205-52 does not effect "an allowability limitation" on a cost measured by CAS. Rather, it requires a completely different measurement process using different books and records. *Rice* is not to the contrary. Using the six-step analysis in *Rice*, FAR 31.205-52 relates to steps (1) and (2), not to steps (4) - (6), since the contractor must calculate the "allowable" costs from scratch.

The administrative history supports the conclusion that there is a prohibited difference between FAR 31.205-52 and the CAS. *See Rice*, 13 F.3d at 1571, "History of CAS." It is reasonably clear that both the CPC, when recommending promulgation of FAR 31.205-52, and the CASB, when adopting the 1996 amendments, understood that there was a conflict between the two. This conflict arose from the fact that, as stated by the CPC, there were two basic approaches to the issue of asset revaluation (which potentially involves double recovery of certain costs). Under one approach, the purchasing contractor revalues the tangible capital assets and the Government recaptures excess depreciation borne by previous contracts from the seller. Under the other approach, the purchasing contractor carries forward the value of the assets as shown on the books of the seller and any recapture of depreciation is deferred until the assets are sold other than as part of a business combination. The CAS adopted the former; FAR 31.205-52 adopted the latter in the case of the sale of a business at a profit.

The CPC in proposing FAR 31.205-52 recognized that the two approaches were mutually exclusive and that a choice needed to be made between them. Thus, it refers to "choosing between these two broad approaches" and a "choice between these two approaches." When commenters stated that they considered "the proposed rule to be a measurement rule thinly disguised as an allowability rule," the CPC agreed that the issue was "the crux" of the case. The CPC advanced two justifications for proceeding with the rule. The first was that the rule was "merely an 'allowability'" rule. The second was "that common sense dictates that there must be some way to remedy an inequity without waiting several years . . . ." Therefore, the CPC proposed going ahead without waiting for the CASB, which at that time had just been reconstituted, to act in the area. Implicit in this justification is the understanding that the CPC was, indeed, regulating in an area which was the domain of the CASB.

The CASB explicitly recognized the appearance of a conflict. It stated both in the NPRM that "[t]he Board is aware of the apparent conflict" and in the preamble to CAS 404 and 409 as amended in April 1996 that "[t]he Board is aware that there is an appearance of conflict between the provisions of CAS 9904.404 and FAR 31.205-52." The majority states that this conflict relates "to the difference between FAR 31.205-52, as promulgated, and CAS 404, as *amended* in 1996, five years after the contract dispute arose here. At issue in this appeal is CAS 404 prior to amendment" (*supra*, slip op. at 53). If there was a conflict after the amendment, *a fortiori* there was one before. That is because FAR

31.205-52 only applied to sales of a business at a profit, not all business combinations. After the amendment there was a conflict because FAR 31.205-52 allowed the use of the purchase method of accounting in the case of the sale of a business at a loss and CAS 404 did not (where tangible capital assets had generated costs to Government contracts). Before the amendment there was a conflict because FAR 31.205-52 did not allow the use of the purchase method of accounting in the case of the sale of a business at a profit and CAS 404 did.

The majority states that "[t]he lack of action to block promulgation or rescind the FAR, in the face of *express* congressional direction to take such action when a regulation is deemed 'inconsistent with a cost accounting standard,' demonstrates that the 'administrative history' here clearly does *not* support the dissent's 'conclusion' that the regulators recognized 'there was a prohibited difference between FAR 31.205-52 and the CAS'" (*supra*, slip. op. at 54-55). Although it is true the promulgation of FAR 31.205-52 was not blocked or rescinded, the record reflects not a "lack of action," but rather an effort extending from 1990 (when the reconstituted CASB held its first meeting) until 1998 (when FAR 31.205-52 was revised) to resolve the conflict in this area between the CAS and the FAR.

I conclude, therefore, that the appeal should be sustained insofar as it relates to tangible capital assets. Although the same result possibly should obtain with respect to intangible capital assets, appellant has not pointed to comparable regulatory language or administrative history with respect to them. Accordingly, I concur in the result without joining in the discussion insofar as the appeal relates to intangible capital assets.

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. 44832, Appeal of BAE Systems Information & Electronic Systems Integration, Inc. (formerly Lockheed Martin IR Imaging Systems, Inc., and Loral Infrared and Imaging Systems, Inc.), rendered in conformance with the Board's Charter.

Dated:

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