ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Kearfott Guidance & Navigation Corporation	)	ASBCA No. 45536
	)	
Under Contract No. N00030-92-C-0043	)	

APPEARANCE FOR THE APPELLANT: Samuel Paige, Esq.
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OPINION BY ADMINISTRATIVE JUDGE HARTMAN
ON THE GOVERNMENT'S MOTION FOR SUMMARY JUDGMENT

The Government contends in this appeal, as in *BAE Systems Information & Electronic Systems Integration, Inc.*, ASBCA No. 44832 slip op. at 1 (29 June 2001), that Federal Acquisition Regulation (FAR) 31.205-52 "disallows" costs claimed under a cost-reimbursement contract which arise from appellant's "write-up" of asset values pursuant to a "business combination." According to the Government, after the effective date of the FAR, if a contractor uses 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, however, contends FAR 31.205-52 bars costs arising from a "write-up" of asset values only with respect to business combinations occurring after the FAR's effective date. It contends, alternatively, that FAR 31.205-52 does not apply because the FAR constitutes a "taking without compensation contrary to the Fifth Amendment of the Constitution," is an "illegal retroactive regulation," and conflicts with Cost Accounting Standard (CAS) 404 and 409 concerning "allocation" of costs.

STATEMENT OF FACTS

Prior to 1987, The Singer Company (Singer) had various operating divisions. One of the divisions, Kearfott Guidance & Navigation Division (KGN Division), was involved in the defense industry. (R4, tab 3; supp. R4, tab 1 at 5; Appellant's Brief In Opposition To Respondent's Summary Judgment Motion (app. opp.) at 2, ex. 4; Government's Motion For Summary Judgment (Gov't SJM) at 1)

In December of 1987, Singer incorporated in the State of Delaware a new, wholly-owned subsidiary, The Singer Acquisition Company No. 4 (SAC4). During April 1988, Singer caused to be filed with the State of Delaware a certificate changing the name of the company from SAC4 to "KEARFOTT GUIDANCE & NAVIGATION CORPORATION" (Kearfott), and transferred to the company assets and liabilities of its KGN Division, including contracts entered into with the Department of Defense. On 19 August 1988, Singer, Kearfott and the United States executed a novation agreement, which recognized Kearfott as Singer's "successor in interest in and to the contracts" and provided that, "[s]olely with respect to calculation of costs charged to Government contracts," Kearfott would "not write-up the value of depreciated assets transferred to it" by Singer on "any current contracts or any contracts entered into with the Government between April 25, 1988, and April 25, 1991." (R4, tab 2 at 2, 4, 10, 11; supp. R4, tab 3 at ex. 3; app. opp. at 1; Gov't SJM at 1-2; Amended Complaint (am. compl.) ¶¶ 1, 2)

On 30 August 1988, Astronautics Corporation of America (ACA), a Wisconsin corporation, entered into an agreement with Aerospace Holdings Company (Aerospace), a wholly-owned subsidiary of Singer, to purchase all the issued and outstanding shares of Kearfott capital stock for $285 million (Purchase Agreement). The Purchase Agreement provided that either ACA or Aerospace could assign its rights under the agreement to a wholly-owned subsidiary. The Purchase Agreement additionally provided that Aerospace would "cause The Singer Company, a Delaware corporation and the common parent of the affiliated group of which [it] is a member, to join with [ACA] in making an election under Section 338(h)(10) of the [Internal Revenue] Code . . . to treat the sale of the Stock as a sale of assets for federal income tax purposes," and that ACA would retain one of two specified appraisal firms "to determine the fair market value" of Kearfott's assets "for the purpose of allocating the purchase price among such assets in accordance with the residual allocation method." (Am. compl. ¶¶ 3, 4, 11, 12; app. opp. at 3-4; Gov't SJM at 2; supp. R4, tab 1)

During September of 1988, ACA incorporated in the State of Delaware a wholly-owned subsidiary, KGN Sub, Inc. (KGN Sub), and assigned and transferred to KGN Sub all its rights, title and interest under the Purchase Agreement. KGN Sub then entered into a $145 million credit agreement with Continental Illinois National Bank & Trust Company (CINB&TC), as agent for a consortium of financial institutions (Credit

Agreement). (Am. compl. ¶¶ 5, 6, 7; app. opp. at 3-4; Gov't SJM at 2-3; app. supp. R4, tabs 1, 2; supp. R4, tab 3)

Prior to closing of the Purchase Agreement, the appraisal firm retained by ACA performed an appraisal of the fair market value of Kearfott's assets. The firm's appraisal supported an increase in the valuation of the assets. (Am. compl. ¶¶ 13, 15; app. opp. at 4; Gov't SJM at 4)

On 4 October 1988, pursuant to the Purchase Agreement, KGN Sub paid Aerospace $285 million — $145 million obtained pursuant to the CINB&TC Credit Agreement, $50 million obtained pursuant to a loan from ACA, and purchase by ACA of equity in Kearfott of $90 million. The same day, KGN Sub filed with the State of Delaware a "Certificate of Ownership and Merger merging KGN Sub, Inc., into Kearfott Guidance & Navigation Corporation." The Certificate provided that Kearfott would be the surviving corporation, which assumed all rights and liabilities of KGN Sub, and would retain the name "Kearfott Guidance & Navigation Corporation." All members of Kearfott's board of directors, including its chairman and key officers, submitted their resignations that day, and new directors were elected to replace those who resigned. In addition, pursuant to the Purchase Agreement, Singer and ACA executed on that day and submitted to the Internal Revenue Service a Form 8023 electing to treat the sale of Kearfott as a "purchase of assets." (Am. compl. ¶¶ 8, 10, 14; app. opp. at 4-5; Gov't SJM at 3-4; app. supp. R4, tabs 2, 4; supp. R4, tabs 1, 3, 4)

Approximately 17 months later, on 23 July 1990, FAR 32.205-52 entitled "ASSET VALUATIONS RESULTING FROM BUSINESS COMBINATIONS" became effective. FAR 32.205-52 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.

(R4, tab 6; Gov't SJM at 5-6; 55 Fed. Reg. 25,522 (1990))

During May 1992, the Department of the Navy awarded to Kearfott Contract No. N00030-92-C-0043. Section H of the contract provided:

> The target cost and target profit of this contract do not include amounts for asset valuations of assets transferred to Kearfott Guidance & Navigation Corporation by the Singer Company. The Government and the Contractor are in disagreement as to the allowability of the costs of such asset valuations. This contract shall be subject to a one time equitable adjustment to

> include amounts for such asset valuations, under any of the following circumstances: (1) the Administrative or Procuring Contracting Officer agrees with the Contractor that the costs of such asset valuations are allowable, (2) a Court or Board of competent jurisdiction decides that the costs of such asset valuations are allowable based on a claim under this contract, or (3) a Court or Board of competent jurisdiction decides on the merits that the costs of such asset valuations are allowable based on a claim under another contract. In no event shall the equitable adjustment exceed $785,159. In the event that this clause results in an equitable adjustment due to the decision of a Court or Board, the equitable adjustment shall be canceled in the event that the Court or Board is reversed on appeal, at any level.

(Am. compl. ¶ 16; app. opp. at 5; Gov't SJM at 5; R4, tab 4)

Pursuant to the contract, on 3 September 1992, Kearfott submitted to the Navy a progress payment request in the amount of $91,278. Of such amount, the sum of $15,763 was attributable to an increase in the value of Kearfott's assets due to the sale of Kearfott to KGN Sub. The Government refused to pay Kearfott the sum which was attributable to the increase in value of its assets. (Am. compl. ¶¶ 17, 18; Gov't SJM at 5-6; app. opp. at 5-6; R4, tabs 10, 11) With each following progress payment request, Kearfott included amounts associated with the asset write up and the Government excluded those amounts from its payment as "not allowable" (am. compl. ¶¶ 23, 24, 25; Gov't SJM at 6; app. opp. at 6-7; R4, tabs 12 through 18).

Kearfott requested that the administrative contracting officer (ACO) issue a final decision with respect to the ACO's denial of amounts associated with Kearfott's write up of asset values. By letter dated 10 November 1992, the ACO declined to issue a final decision until Kearfott certified its claim for the amounts disallowed because the ultimate amount at issue exceeded $50,000. Kearfott filed an appeal with this Board based upon the ACO's failure to issue a final decision and submitted a certification of its "$15,763 claim" to the ACO. The Government moved to dismiss Kearfott's appeal for lack of jurisdiction, but later withdrew that motion. During June 1993, the ACO issued a final decision denying Kearfott's claim, which stated:

> The contract [at] issue, [No.] N00030-92-C-0043[,] by virtue of the Christian Doctrine[,] includes FAR 31.205-52. . . .
>
> This clause clearly prohibits the write-up of the value [of] assets resulting from Business Combinations after its effective

> date . . . . FAR 31.205-32 applies to any attempt to write up assets in contracts incorporating the clause.
>
> In determining what payments a contractor is entitled to receive, a contracting officer is limited by FAR 52.232-16, "Progress Payments", which provides for the inclusion of "properly allocable and allowable indirect costs." Depreciation on contractor acquired facilities under Section H . . . shall be allowable in accordance with Part 31 of the FAR. In addition[,] the Cost of Money, FAR 52.215-30, is limited by the requirements of FAR 31.205-52. Kearfott is precluded from writing up its assets under FAR 31.205-52.

(Am. compl. ¶¶ 19 through 22; Gov't SJM at 6; app. opp. at 6; R4, tabs 19 through 25; ACO final decision at 5-6)

In September of 1993, Kearfott submitted to the ACO a letter stating:

> On January 6, 1993, Kearfott submitted to you a certification for said sum of $15,763.00. Because of continued performance by Kearfott under subject Contract, the claim of Kearfott as of August 31, 1993 is the sum of $352,446.00. As performance under subject Contract continues, the sum to which Kearfott will be entitled will increase from $352,446.00 to $785,159.00.

Enclosed with Kearfott's letter was another claim certification. (Am. compl. ¶ 23; Gov't SJM at 6; app. opp. at 6; R4, tabs 19 through 25)

In January of 1994, Kearfott sought and received permission to file an amended complaint. The amended complaint contained three counts which alleged alternatively: (1) the 1988 novation agreement comprised an advance agreement to allow costs based upon stepped-up asset values after April 1991; (2) the CO was estopped from refusing to allow costs resulting from the step-up of assets; and (3) Kearfott was entitled to step-up its asset values as re-computed and recover the costs sought.

The Government subsequently filed a motion for summary judgment, and Kearfott filed an opposition to that motion. After the Government submitted a reply to Kearfott's opposition to its motion and Kearfott filed a reply to the Government's reply (app. supp. opp.), Ametek Aerospace Products, Inc. (Ametek) filed a motion seeking leave to file an *amicus curiae* brief in this appeal because the appeal presents issues concerning FAR 31.205-52 similar to those in another appeal of Ametek's, ASBCA No. 45307, which are "critical to a vast array of government contractors."

Neither party filed an opposition to Ametek's motion for leave when the Board sought a response to that motion. Kearfott advised the Board that it was "in full accord with the *amicus* brief and believes that [the brief] will be of substantial assistance to the Board . . . ." The Government did not submit a response to Ametek's motion for leave, but filed a 19-page brief responding to the contentions in Ametek's brief. Thereafter, this Board granted Ametek's motion for leave to file its *amicus curiae* brief (*amicus* br.). It also issued a decision granting the Government's summary judgment motion with respect to counts 1 and 2 of the amended complaint. *Kearfott Guidance & Navigation Corp*., ASBCA No. 45536, 95-2 BCA ¶ 27,773. The Board stated in its decision that it would address issues raised by the remaining count of the complaint in a separate, subsequent opinion. *Id*. at 138,466.

DECISION

Kearfott and *amicus curiae* both contend that the Government is not entitled to grant of summary judgment here because FAR 31.205-52 is not applicable to business combinations which occurred prior to its effective date. They assert that: by its wording, FAR 31.205-52 is applicable when the "purchase method" of accounting "is used"; the purchase method of accounting "is used" at the time of a business combination to adjust asset valuations; and Kearfott's business combination and resulting asset re-valuation at issue occurred prior to 23 July 1990, the effective date of the FAR provision. (App. opp. at 18-20; app. supp. opp. at 2-4; *amicus* br. at 2-3)

In our recent decision in *BAE Sys. Info. & Elec. Sys. Integration, Inc.*, ASBCA No. 44832, slip op. at 21-25 (29 June 2001), we held that the plain language of FAR 31.205-52 mandates that, where the "purchase method of accounting for a business combination" is used to report income utilizing the operations of an acquired division based upon the cost of that division to the acquirer, 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. We explained that, under Accounting Principles Board Opinion No. 16, the "purchase method of accounting" does not comprise simply a "step-up" in values of the assets acquired, *i.e*., recording at cost of 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 upon cost to the acquiring corporation. An acquiring corporation, therefore, continues to "use" the "purchase method of accounting" after it "steps up" the values of assets acquired in a business combination. We noted that, where 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.'" BAE's (and Kearfott's) construction of the FAR as referencing "solely" the event of "step-up" of acquired asset values, which occurs at time of acquisition/business combination, thus, is not reasonable. The technical words "purchase method of accounting" plainly also refer to the reporting of income *after* acquisition/business combination, using operations of the

acquired based upon cost to the acquiring corporation. *See, e.g., Corning Glass Works v. Brennan*, 417 U.S. 188, 201-02 (1974); *Shell Petroleum, Inc. v. United States*, 182 F.3d 212, 217 (3d Cir. 1999). Accordingly, under our holding in *BAE Sys. Info.*, the ACO here correctly concluded that, under FAR 31.205-52, Kearfott's allowable amortization, cost of money and depreciation is limited to the total of amounts which would have been allowed had the business combination not taken place.

Kearfott and *amicus curiae* also contend the Government is not entitled to grant of summary judgment here because Kearfott should not be subject to retroactive application of FAR 31.205-52. They assert there has been no express grant of power by Congress to issue "retroactive" cost principles. (App. opp. at 20-24; *amicus* br. at 3-15)

In our decision in *BAE Sys. Info., supra,* slip op. at 40-44, however, we also held that FAR 31.205-52 does not operate "retroactively." We stated that 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 one's expectations based on prior law. *See, e.g., Landgraf v. USI Films Prods.*, 511 U.S. 244, 268-70, 280 (1994); *Travenol Laboratories, Inc. v. United States*, 118 F.3d 749, 752-53 (Fed. Cir. 1997). We explained that: it was the contractor's use of the purchase method to account for income *after* its contract was awarded that caused the FAR to apply; the Government therefore was applying cost reimbursement principles in effect at time of contract award, not a new reimbursement principle to previously incurred expenses; the contractor did not possess a vested right to reimbursement of contract costs based on the write-up of asset values, but an expectation that cost reimbursement would be made in accordance with principles in effect at time of contract award; and thus the FAR did not attach new consequences to an event completed before its promulgation sufficient to constitute an "illegal" "retroactive" regulation. *See Pasadena Hosp. Ass'n, Ltd. v. United States,* 618 F.2d 728, 732, 735 (Ct. Cl. 1980) (regulation disallowing the reimbursement of rental expenses owed to a related organization under a lease executed prior to promulgation of regulation not "retroactive"); *see also Litton Sys., Inc. v. United States*, 449 F.2d 392, 401 (Ct. Cl. 1971); *Westinghouse Elec. Corp. Defense Group,* ASBCA No. 22923, 79-2 BCA ¶ 13,972. Thus, under our holding in *BAE Sys. Info., supra*, as a matter of law, there is no violation of due process based on "retroactivity" which could serve as a basis for us to "strike down" or invalidate FAR 31.205-52.

Kearfott additionally contends that application of FAR 31.205-52 to a business combination occurring before the effective date of that regulation constitutes a taking of property without just compensation contrary to the Fifth Amendment (app. opp. at 24). As we explained in *BAE Sys. Info., supra*, slip op. at 29-31, however, it is well established that we do not possess jurisdiction to entertain a claim founded upon the Takings Clause of the Fifth Amendment. *E.g., United Technologies Corp., Pratt & Whitney Group,* ASBCA Nos. 46880, *et al.*, 95-1 BCA ¶ 27,456 at 136,770. We thus lack authority to entertain

Kearfott's assertions concerning the Government's taking of property without just compensation and express no views regarding the merits of any such claim.

Finally, Kearfott contends that the Government is not entitled to grant of summary judgment because FAR 31.205-52 conflicts with CAS 404 and 409. Kearfott asserts that: CAS requires asset valuations to be based on the purchase method of accounting set forth in Accounting Principles Board Opinion No. 16; FAR 31.205-52 is a measurement, rather than "allowability," rule because depreciation charges "flowing from" asset revaluations under the rule are not in accord with the purchase method; and CAS prevails in the event of a conflict between CAS and FAR. (App. opp. at 24-25)

The same assertions were made in *BAE Sys. Info., supra*, slip op. at 46-55. In that appeal, we held there was no irreconcilable conflict between CAS and FAR 31.205-52. We explained that: the development and operation of the FAR determines whether it is an allowability or allocability provision; the FAR was developed to be, and operates as, an "allowability" provision, rather than an "allocability" provision; and thus there is no conflict between FAR 31.205-52 and the CAS which would allow us to not enforce the FAR. *Id*.; *see Rice v. Martin Marietta Corp*., 13 F.3d 1563, 1568-70 (Fed. Cir. 1994); *General Elec. Co. v. United States*, 929 F.2d 679, 682 (Fed. Cir. 1991); *United States v. Boeing Co*., 802 F.2d 1390, 1394 (Fed. Cir. 1986); *Emerson Elec. Co*., ASBCA No. 30090, 87-1 BCA ¶ 19,478 at 98,425. We noted that: by its express terms, the FAR applies only where a contractor utilizes, and complies with, the "purchase method" of accounting for a business combination; a contractor therefore is free to measure the value of tangible assets acquired in a business combination in accordance with the "purchase method" and assign capitalized values to accounting periods as depreciation pursuant to CAS 404 and 409; and the FAR merely limits a contractor from receiving reimbursement under Government contracts for a part of the costs measured and assigned under CAS based on a rational procurement policy concerning duplicate overhead reimbursement, which is independent of the cost accounting considerations of proper assignment and allocation of costs. *BAE Sys. Info., supra*, slip op. at 35-38, 42-50; *see Rice v. Martin Marietta Corp*., 13 F.3d at 1568-70; *Boeing Co*. 802 F.2d at 1394; *compare* FAR 31.205-52 *with* FAR 31.205-6 (senior executive compensation is allowable to extent it does not exceed Government's benchmark compensation), FAR 31.205-46 (personnel travel cost is allowable provided it is reasonable; cost considered reasonable to extent it does not exceed Government's maximum *per diem* rates), and FAR 31.205-49 (goodwill created under "purchase method" by business combination is not allowable). Thus, under our holding in *BAE Sys. Info*., as a matter of law, there also is no conflict between CAS and FAR 31.205-52 which could serve as a basis for us to "strike down" or invalidate FAR 31.205-52.[*]

[*] In *Ametek Aerospace Products, Inc.*, ASBCA No. 45307, 00-2 BCA ¶ 31,080, we denied the appeal based on *Marquardt Co. v. United States*, 822 F.2d 1573 (Fed. Cir. 1987), because a parent company's cost of acquiring all the stock of a new wholly-owned subsidiary was not an expense incurred by the acquired company, and did not address the

In sum, the ACO correctly determined that, under FAR 31.205-52, Kearfott's allowable amortization, cost of money and depreciation is limited to the total of amounts which would have been allowed had the business combination not taken place. Because there are no genuine issues of material fact with respect to the Government's motion and the Government is entitled to entry of judgment as a matter of law, the Government also is entitled to grant of summary judgment with respect to the third count of the amended complaint.

CONCLUSION

The Government's motion for summary judgment is also granted with respect to count three of the amended complaint. 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

contractor's contentions concerning CAS 404 and FAR 31.205-52. While this appeal resembles Ametek because a "parent" company initially acquired the stock of a new wholly-owned subsidiary, the two appeals differ because the parent and subsidiary companies here merged shortly after the parent acquired the subsidiary, and the surviving company possessed the assets and liabilities of both companies. *See Ametek, supra*, at 153,451; *Times Fiber Communications, Inc. & Times Microwave Sys., Inc., ASBCA No. 37301,* 91-2 BCA ¶ 24,013 at 120,218, 120,220. Accordingly, our prior ruling in *BAE Sys. Info., supra*, rather than *Ametek, supra*, applies here.

I concur

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

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

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

SEPARATE OPINION BY JUDGE THOMAS

I dissent in part and concur in result in part, without joining in the discussion, for the reasons stated in my separate opinion with respect to 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.), decided on 29 June 2001.

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. 45536, Appeal of Kearfott Guidance & Navigation Corporation, rendered in conformance with the Board's Charter.

Dated:

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