ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --	)	
	)	
United Technologies Corporation,	)	
Pratt & Whitney	)	ASBCA Nos. 47416, 50453, 54512
	)	
Under Contract No. F33657-84-C-2263 and	)	
All CAS Covered Contracts	)	

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DECISION BY JUDGE PARK-CONROY
ON APPELLANT'S ESTOPPEL AND RELATED EQUITABLE DEFENSES

ASBCA Nos. 47416 and 50453 were remanded to the Board by the United States Court of Appeals for the Federal Circuit (CAFC) to address the estoppel defense raised by appellant United Technologies Corporation (UTC), Pratt & Whitney Group (Pratt) and the quantum of the government's damages after it vacated our entitlement decision reported as *United Technologies Corporation, Pratt & Whitney,* ASBCA Nos. 47416 *et al.*, 01-2 BCA ¶ 31,592 (redacted version). *See Rumsfeld v. United Technologies Corp.*, 315 F.3d 1361 (Fed. Cir. 2003), *cert. denied*, 540 U.S. 1012 (2003). The CAFC held that, under Cost Accounting Standards (CAS) 410, 418, and 420, appellant was required to include a cost for parts obtained under collaboration agreements with foreign suppliers in the bases used to allocate indirect expenses. *Id.*, 315 F.3d at 1377.

A Petition for Rehearing or Rehearing en Banc was filed by Pratt on 28 February 2003 and supported by an *Amici Curiae* Brief filed on 5 March 2003. As is relevant to the issues now pending, both submissions argued that the CAFC's instruction on estoppel, in particular the need to show "affirmative misconduct on the part of the government," addressed an issue that was not before the court and ignored precedent precluding the government from retroactive cost disallowances established by *Litton Systems, Inc. v. United States*, 449 F.2d 392, 398 (Ct. Cl. 1971). (Gov't resp., append. at 1-12) The petition was denied. *Rumsfeld v. United Technologies Corp.*, 2003 U.S. App. Lexis 9624 (Fed. Cir. 23 Apr. 2003).

After the remand, the appeals were stayed without objection by the government pending Pratt's Petition for a Writ of Certiorari to the United States Supreme Court. There, it again argued that the CAFC had erred in summarily extending the estoppel requirement of showing "affirmative misconduct" on the part of the government to a contract setting and in disregard of longstanding precedent on the application of estoppel, including *Litton*. (Gov't resp., append. at 22-40) The petition for certiorari was also denied. *United Technologies Corp. v. Rumsfeld*, 540 U.S. 1012 (2003).

On 20 February 2004, Pratt filed an appeal from the contracting officer's demand for an additional payment of $494,392,867.00, increasing the amount sought by the government for CAS 410, 418 and 420 noncompliances to $754,682,517,00. The appeal was docketed as ASBCA No. 54512.

On 27 August 2004, the parties filed separate reports under Board Rule 32 recommending procedures to comply with the CAFC's remand. On 29 September 2004, following a telephone conference call, the Board directed the parties to submit new briefs addressing appellant's estoppel defense, including the "affirmative misconduct" element, and to proceed with discovery in the quantum phase of the appeals. The Board then denied the government's motion to strike the reference to "affirmative misconduct" in paragraph 39 of appellant's complaint in ASBCA No. 54512 and consolidated the new appeal with ASBCA Nos. 47416 and 50453 for purposes of deciding the remaining estoppel and quantum issues.

The estoppel issue has now been fully briefed and is ripe for disposition. This opinion restates and summarizes relevant findings made in our earlier decision and makes such additional findings as are appropriate and necessary to appellant's estoppel and related equitable defenses.

FINDINGS OF FACT ON ESTOPPEL

During the relevant period, Pratt was divided into four organizational units. Manufacturing Division (MD) (later re-named Manufacturing Operations (MO))

performed all manufacturing operations relating to commercial and military jets. Commercial Products Division (CPD) (later re-named Commercial Engine Business (CEB)) developed and sold jet engines and parts to the commercial marketplace. Government Products Division (GPD) designed, developed and sold jet engines to the government. Group performed office management and administrative support for the three divisions. (Ex. A-18; tr. 4/74-75)

These appeals involve a number of CAS accounting practices. MD allocated its material overhead (MOH) over a direct material cost input base that did not include any cost or value for collaboration parts and did not transfer to CPD any cost or value for collaboration parts. CPD allocated its general and administrative (G&A) expenses over a total cost input base comprised of CPD expenses and the cost of engines and spare parts transferred to CPD from MD. By 1989, CPD excluded any cost or value for collaboration material from the total cost input base it used to allocate G&A and independent research and development and bid and proposal (IR&D/B&P) costs. 01-2 BCA ¶ 31,592 at 156,112-13. All IR&D/B&P costs were accumulated by Group and then allocated back to CPD and GPD on a percentage basis (tr. 7/188).

Pratt did not include Government furnished material (GFM) in either MD's direct material cost input base or CPD's total cost input base. 01-2 BCA ¶ 31,592 at 156,113. It is undisputed that it has been government policy for many years to exclude GFM from a contractor's indirect cost allocation bases (R4, tab 810).

On 15 May 1980, the Cost Accounting Standards Board (CASB) promulgated CAS 418, ALLOCATION OF DIRECT AND INDIRECT COSTS, which had an effective date of 20 September 1980, and became applicable to Pratt on 1 January 1982. 01-2 BCA ¶ 31,592 at 156,105. In general, CAS 418 requires that overhead costs be accumulated in pools that are homogeneous in their relationship to final cost objectives based on their "beneficial or causal relationship." Department of Defense (DoD) Working Group Paper 77-10 allows for the retroactive implementation of CAS when timely compliance is not feasible (R4, tab 382). Equitable price adjustments to achieve compliance with new cost accounting standards for CAS-covered-contracts and subcontracts awarded prior to the effective date of each new standard are limited to mandatory changes (R4, tab 641 at 6481a; gov't resp., append. at 51-53).

Pratt establishes reserve amounts that accrue against earnings in a current time period to protect against potential future risks in government contracting, such as CAS and defective pricing issues (tr. 6/212). It determined that MD should establish such reserves for potential CAS 418 compliance issues and did so annually from 1982 through 1987 (tr. 6/213-14).

During the early 1980's time period, Pratt began to evaluate and discuss options for the proper accounting treatment of the parts it anticipated obtaining from foreign entities for its commercial engine programs as a result of the collaboration program it was expanding and refining. The first collaboration agreement had been executed with Motoren-und Turbinen-Union Muenchen GmbH (MTU) of Germany and Fiat Aviazione Societa Per Azioni (Fiat) of Italy in 1977 for development of the JT10D engine. 01-2 BCA ¶ 31,592 at 156,108. The agreement had been provided to Mr. John Ford, a Navy contracting officer, who in turn requested legal review. The Navy's Deputy Assistant General Counsel (Acquisition) concluded that Pratt's development costs for the JT10D engine program with MTU/Fiat could not be charged to IR&D (R4, tabs 108, 109).

Other government officials, in particular at the Air Force Plant Representative Office (AFPRO), obtained general information about the program through news media accounts that provided varying degrees of information, such as the names of the collaborators, the engine programs in which they participated, and the percentage of their participation (R4, tabs 703, 704, 706, 708, 710, 726, 764, 773, 780, 781, 861).

All of the accounting options initially considered by Pratt for commercial parts it expected to obtain from its collaborators included assigning a value to these parts in its indirect cost allocation bases (R4, tabs 110 through 116, 121, 124, 130-31, 134-37, 139-40, 142-43). Although Pratt did not consider revenue share payments to collaborators to be a valuation option, it nevertheless did recognize that the government "could very well insist" that it was the "suitable value" (R4, tab 111 at 2). There is no evidence that the government was aware of these early, internal accounting considerations.

MD's Pre-CAS 418 Baseline Disclosure Statement

Pratt submitted a revised MD Disclosure Statement to the contracting officer on 3 March 1982 that included voluntary changes relating to vacation accruals and surface treatment costs. It had nothing to do with CAS 418 and came to be known as MD's Pre-CAS 418 "Baseline" Disclosure Statement. (R4, tab 601; tr. 4/162)

Item 2.2.2 "Charges from Central or Common, Company-Owned Inventory Account" advised in "(A) Standard Material Cost – Production Effort" that standard material costs were established and reviewed annually and summarized the updating procedure (R4, tab 601 at 5 of 59). "Standard Material Costs" include the costs that MD establishes for materials, including purchased parts, on an annual basis (tr. 4/163-65, 5/22-23). Item 4.1.0 "Overhead Pools and Allocation Bases" under (n) "Other Pools" included "Material Overhead: Allocated to production contracts on a standard direct production material input cost base using a standard absorption rate" (R4, tab 601 at 18 of 59). Item 4.6.0 "Allocation Base" states at (C) that the "Total Manufacturing Cost

Input Base under (4.2.0) (e) is made up of input" that includes "Standard Direct Material/Job Order Direct Material" (*id*. at 39, 40 of 59). Item 4.6.0 (L) "Direct Material Cost" included a "Standard Direct Production Material Input Cost Base" defined as consisting of "input standard production direct material, dual source substitution, spoiled work and defective material variances" (*id.* at 41 of 59). Pratt followed this statement until its 30 June 1987 and 30 September 1987 Disclosure Statements were determined to be CAS compliant (tr. 5/24).

MD's CAS 418 Initial Disclosure Statement and Revisions

MD's first CAS 418 Disclosure Statement had been submitted to the contracting officer on 26 November 1980. It was signed by Mr. Stephen A. Mason, Manager of Government Accounting, who was responsible for identifying accounting practices and changes required by CAS and submitting CAS Disclosure Statements. (R4, tab 600; tr. 4/128-29)

By a letter dated 30 November 1981, Defense Contract Audit Agency (DCAA) Resident Auditor Thomas Potter provided Pratt with a draft audit report (No. 2640-1D441006) that concluded that the November 1980 Disclosure Statement would not bring MD into compliance with CAS 418 (R4, tab 721). The final audit report was issued 29 December 1981 (R4, tab 727).

Pratt submitted a revised CAS 418 Disclosure Statement on 30 June 1982 (R4, tab 602). As is relevant here, Items 2.2.2 (A), 4.1.0 (n) and 4.6.0 (C) and (L) were similar to the 3 March 1982 Pre-Cas 418 Baseline Disclosure Statement (R4, tab 600 at 5, 18, 40, 41 of 59, tab 601 at 5, 18, 40, 41 of 59, tab 602 at 4, 13, 29, 30 of 43). The Administrative Contracting Officer (ACO), Mr. Edward M. Lawton, ultimately issued a Final Determination of Noncompliance for Pratt's revised statement on 7 April 1983 (R4, tab 132). Before doing so, he advised Pratt that "no financial actions would be taken" against Pratt so long as it was making progress in achieving compliance through development of its New Accounting System (NAS). 01-2 BCA ¶ 31,592 at 156,114-15.

On 6 July 1983, Pratt made a presentation to the government on its proposed accounting changes to comply with CAS 418, including development of a NAS for "collaboration agreements and joint ventures." Mr. Lawton, Mr. James Swift, then with the AFPRO, and the DCAA's Mr. Potter were among the attendees. Mr. Swift's responsibilities included advising the ACO on CAS disclosure statements (tr. 7/98-99). After the meeting, Mr. J. M. O'Brien, Chief of the AFPRO Business Management Branch, requested that Pratt provide necessary review information regarding which of the accounting changes it considered to be mandatory and which it considered to be voluntary under CAS 418, and why. Mr. O'Brien wanted to identify the cost impact of mandatory changes resulting from CAS 418 that might entitle Pratt to an equitable

adjustment. (R4, tabs 90, 746) Mandatory changes could cause an upward adjustment in prices, while voluntary changes would result in downward price adjustments only (tr. 6/158). As summarized later by Mr. Potter in a memo to Mr. Swift, Pratt's 2 September 1983 response to Mr. O'Brien's request indicated that MD considered development of a NAS for "COLLABORATION AGREEMENTS AND JOINT VENTURES" to be a mandatory change (R4, tab 921 at 1522; tr. 7/106-110).

Thereafter, Pratt submitted several draft CAS 418 and NAS Disclosure Statements. The purpose of submitting draft disclosure statements was to communicate proposed changes to the government and avoid formal audit reports and citations of non-compliance. (R4, tabs 603 to 610, tr. 4/153-55)

The Initial CAS 418 Disclosure Statement

On 30 September 1983, Pratt submitted its "Initial Proposal" for MD's CAS 418 Disclosure Statement. It contained information regarding collaboration agreements and materials. (R4, tab 603) Item 2.1.0 "Description of Principal Direct Materials" advised that "[c]ollaboration agreements are discussed in Section 4.7.0" (*id*. at 2 of 34). The following statement was contained in Item 4.7.0 "Application of Overhead and G&A Rates to Specific Transactions or Costs," paragraph (i) "Other Transactions or Cost:"

> Collaboration Agreements
>
> Material cost accounted for under collaboration agreements utilize only apart [sic] of the services provided by the Material Overhead pool. The MD material overhead provides the following services: a) All the services of the Materials Department, b) Purchasing performs all services except for price negotiation, and c) Quality Assurance Department only provides their quality audit and systems group services.
>
> The cost of the above services provided are charged directly to the collaboration material cost and credited from the material overhead pool. The distribution base for the charging of material overhead services is total material input cost for the current year. (Rev. 21 – 9/30/83).

(*Id.* at 33, 34 of 34)

Item 2.2.2 (A) "Standard Material Cost – Production Effort" continued to include "purchased parts" (R4, tab 603 at 4 of 34). Item 4.6.0 "Allocation Base" continued to include "Standard Direct Material/Job Order Direct Material" in (C) "Total

Manufacturing Cost Input Base" as it had in the Pre-CAS 418 Baseline and the 30 June 1982 CAS 418 Disclosure Statements, but for the first time indicated that the total cost input base also would include a "less than full" or "Abated Material Overhead" (R4, tab 601 at 40 of 59, tab 602 at 29 of 43, tab 603 at 31 of 34). The Abated Material Overhead entry was intended for collaboration materials (tr. 4/175-76). 01-2 BCA ¶ 31,592 at 156,115. Items 4.1.0 (n) continued to reflect that material overhead was allocated over a base that included "input standard production direct material" and 4.6.0 (L) continued to include "input standard production direct material" as part of its direct material cost input base (R4, tab 603 at 14, 32 of 34).

The statement was referred to DCAA for an adequacy and compliance review. Mr. James L. Kelley replaced Mr. Potter as the DCAA Resident Auditor in 1983 (Kelley dep. at 15). On 17 February 1984, he advised the AFPRO that the Disclosure Statement was inadequate and that the inadequacies were unavoidable because Pratt was "attempting to disclose the accounting practices and changes . . . on a 'piece-meal' basis." He further advised that, due to the inadequacies, DCAA was unable to "arrive at a conclusion of compliance/noncompliance." (R4, tab 754)

Further Disclosure Statement Revisions

Pratt continued to work on MD's CAS 418 Disclosure Statement and submitted another, and major, revision on 24 February 1984. As it had in the 30 September 1983 Disclosure Statement, Item 2.1.0 "Description of Principal Direct Materials," advised: "Collaboration agreements are discussed in Section 4.7.0. (Rev. 21 – 02/24/84)." There was not, however, any discussion or reference to collaboration agreements or materials in that section (R4, tab 604 at 2, 36-37 of 48). Item 2.2.2 (A) "Standard Material Cost - Production Effort" was revised to read as follows:

> Standard Material costs for raw material, purchased parts, fuel and oil, and Special Manufacturing Inventories are established and reviewed annually. The Accounting Procedures and Practices Manual, Volume III, under "Procedure for the Development of Standard Cost" describes in detail the methods used to establish standard cost. (Rev. 21 – 02/24/84)

(R4, tab 605 at 4 of 49)

Additionally, Item 4.1.0 "Overhead Pools and Allocation Bases," (n) "Other Pools," described three separate MOH pools: Purchasing, Material Handling and Vendor Quality Assurance. The three separate MOH pools corresponded with the same three services previously provided by the single MOH pool that had been described in Item

4.7.0 (i) of the initial 30 September 1983 Disclosure Statement. (R4, tab 603 at 34 of 34, tab 604 at 16 of 48) Item 4.6.0 (C) continued to include "Standard Direct Material/Job Order Direct Material," but not Abated Material Overhead (R4, tab 604 at 34 of 48). 01-2 BCA ¶ 31,592 at 156,115.

By a letter dated 23 March 1984, Pratt asked the ACO to substitute a one-page supplement to its 24 February 1984 CAS 418 Disclosure Statement. In the attached revision, part (L) "Direct Material Cost (Input)" of Item 4.6.0 was defined as being "comprised of standard production direct material, consigned material and job order material." With respect to the new category of "Consigned Material," the revision stated:

> - Consists of the estimated value of parts produced by other manufacturers consistent with criteria set forth in specific collaboration agreements and/or Joint Ventures. The estimated costs of these items are predicated on drawings and blueprints provided by the coproducers in conjunction with comparable Manufacturing Division data derived from the production of similar parts.
>
> - Also included in the consigned material base is the estimated value of Government furnished material such as fuel and components, and material provided by the Government Products Division in connection with assist work performed by Manufacturing Division.
>
> . . . .
>
> Consistent with the benefits received concepts in DAR (FAR) and in conjunction with specific contractual requirements, the above elements of direct material cost as appropriate, will be the base for the allocation of Purchasing Overhead, Material Handling Overhead, and Vendor Quality Assurance Overhead. Although the allocations of these overhead pools to cost objectives are designed to be in reasonable proportion to the beneficial or casual [sic] relationship of the pooled cost to cost objectives, pool allocations will not be made in those instances in which material services are provided.

(R4, tab 157)

On 9 August 1984, Mr. Mason met with DCAA personnel, including Mr. James LeClair, to discuss the 24 February 1984 CAS 418 Disclosure Statement. The evidence establishes that the allocation codes for Fiat on the collaboration programs were discussed, but does not reflect the substance of the discussions. Mr. LeClair's notes refer to three engine programs that used Fiat parts (PW2037, JT8D-200, and PW-4000). (R4, tab 769; tr. 4/187-90)

On 22 August 1984, Pratt submitted yet another revised MD CAS 418 Disclosure Statement. Item 2.1.0 dropped the referral reference to Item 4.7.0 for collaboration materials and Item 4.7.0 contained no discussion or reference to collaboration agreements or materials (R4, tab 605 at 2 of 49). Item 2.2.2 (A) "Standard Material Cost – Production Effort" contained the "(Rev. 21 - 02/24/84)" revisions that had first referenced Pratt's Procedure for the Development of Standard Cost (*id*. at 4 of 49). Item 4.1.0 (n) carried forward the three separate MOH pools, although the descriptions were revised and identified as "(Rev. 22)" (*id*. at 17 of 49). Item 4.6.0 (C) replaced the entry "Standard Direct Material/Job Order Direct Material" with "Direct Material" as an element of the total cost input base (*id*. at 34 of 49).

Item 4.6.0 (L) was as quoted above from the 23 March 1984 supplement. Additionally, it stated: "The Direct Material Cost Input base will be used to allocate Purchasing, Material Handling and Vendor Quality Assurance Overhead Pools to cost objectives similar to those shown below." A matrix then listed the three Standard Production Direct Material, Job Order Material, and Consigned Material categories/programs and identified the allocations. The "Consigned Material" category identified the three Fiat engine programs utilizing collaboration materials (PW2037, JT8D-200, PW-4000) and included Government Furnished Material (GFM) and GPD Assist Material. The Consigned Material category was allocated to Purchasing and Material Handling, with GFM and GPD allocated only to Material Handling. Finally, the Disclosure Statement advised that amendments would be incorporated as new programs were developed. (R4, tab 605 at 35-36 of 49) Mr. Swift asked Pratt why there was no allocation to quality assurance for the three commercial Fiat engine programs and was told that the parts came from program partners (tr. 7/103-04).

Mr. Peter Crowe, a senior DCAA auditor, was assigned the task of performing an adequacy and compliance audit of the 22 August 1984 CAS 418 Disclosure Statement (R4, tab 641 at 6470; tr. 6/152, 162-67). The purpose of the DCAA audit was to identify which accounting changes were mandatory and which were voluntary (tr. 6/158). The assignment guidance advised Mr. Crowe that the documentation relating to the CAS 418 noncompliance should be reviewed and organized and that Mr. LeClair had previously been involved with the issues (R4, tab 641 at 6470).

At a 17 November 1985 meeting between Mr. Crowe and representatives of Pratt, in particular Mr. Mason, it was agreed that the 22 August 1984 CAS 418 Disclosure Statement should be compared to the 3 March 1982 Pre-CAS 418 Baseline Disclosure Statement (R4, tab 641 at 6481).

In undertaking the audit, Mr. Crowe was aware that the new category of "Consigned Material" in Item 4.6.0 (L) was separate and distinct from "standard production direct material" (tr. 6/173-74). He also understood that Pratt was proposing to divide MD's MOH pool into three segments (production, material handling, and vendor quality control), to expand the direct material cost input base to include consigned material, and to allocate production and material handling, but not vendor quality assurance from the segmented MOH pool to the consigned materials (R4, tab 643 at 5197-98; tr. 6/172-76). The inclusion of GFM and CPD assist material in the direct material cost input base was also an expansion of the allocation base (R4, tab 601 at 41 of 59, tab 605 at 35-36 of 49; ex. A-1).

Meanwhile, Pratt had submitted a revised draft NAS Disclosure Statement dated 15 May 1985 (R4, tab 606). Item 2.1.0 "Description of Principal Direct Materials" advised that "[c]ollaboration agreements are discussed in Section 4.6.0" (*id*. at 2 of 66). Item 2.2.2 "Charges from Central or Common, Company-Owned Inventory Account at: Production Operations" in (A) "Standard Material Cost" was the same as the 24 February 1984 and 22 August 1984 CAS 418 Disclosure Statements (*id*. at 4 of 66). Item 4.1.0 (n) continued to reflect the three MOH pools (Purchasing Overhead, Material Handling Overhead, and Vendor Quality Assurance Overhead) (*id*. at 29-30 of 66). Item 4.6.0 (C) reverted back to "Standard Direct Material/Job Order Direct Material" entry description in the total cost input base and Item 4.6.0 (L) contained the identical information as that contained in the 22 August 1984 CAS 418 Disclosure Statement (R4 tab 605 at 35-36 of 49, tab 606 at 51-53 of 66). 01-2 BCA ¶ 31,592 at 156,115.

The change to three new fragmented overhead pools was discussed at a 25 February 1986 meeting attended by Pratt's Mr. Mason and DCAA personnel, including Messrs. Kelley, George Innes, a DCAA Supervisory Auditor, and Crowe. DCAA's notes of the meeting reflect that Mr. Crowe expressed the view that the change was not mandatory. The notes also establish that Mr. Mason explained "the reasoning behind their change to 3 pools and its effect on consigned material inventory, in that P&W feels this inventory should not be burdened with vendor quality assurance." (R4, tab 641 at 0495-96) Pratt's "basic premise" was that, because it did not perform vendor quality assurance on the parts, there was no "beneficial/causal relationship of overhead pools to consigned material" (tr. 4/212-13).

Another meeting was held on 12 March 1986 at which the fragmentation of the MOH pool was again discussed. Mr. Crowe again informed Mr. Mason that the

fragmentation of the MOH pool and expansion of the allocation base to include consigned material was not a mandatory CAS 418 change. As a result of this meeting, Mr. Crowe prepared a document titled "Notes and Questions" which he later gave to either Mr. Mason or his subordinate, Mr. George Coleman. (Tr. 4/215-21, 6/179-84) With respect to "Section 4. Overhead Pools & Allocations Bases" under Item 4.1.0 the document states:

> The old "Material Overhead" has been fragmented into 3 new overhead pools as follows:
>
> | Pool | Base |
> |---|---|
> | Production Overhead | Direct Material Costs Input |
> | Material Handling Overhead | Direct Material Cost Input |
> | Vendor Quality Assurance Overhead | Direct Material Cost Input |
>
> "Material Overhead" was and still is considered a homogenous pool in accordance with criteria set forth in CAS 418.50(3)(b)(1). Therefore this change would be considered a voluntary change and subject to downward adjustment only. "Not a Mandatory Change."

(R4, tab 641 at 6439a) With respect to Item 4.6.0 (L) "Direct Material Cost" the document states:

> Consigned material: What is it. It appears that that [sic] this is not a CAS 418 change and therefore will be treated as a voluntary change subject to downward adjustment only.

(*Id*. at 6441a) Mr. Crowe thought Pratt was trying to make a change, but that the information provided did not tell them "what the change was all about" and how the cost would be estimated (tr. 6/204). When he stated that the inclusion of consigned material in the allocation base for material overhead should be treated as a voluntary change, Mr. Crowe meant that the change was not required by CAS 418 (tr. 6/183).

Item 4.6.0 (L) of the 22 August 1984 CAS Disclosure Statement was the first reference Mr. Crowe had seen to collaboration agreements and, apart from the information contained in the statement, he did not know anything about either the agreements or consigned material (tr. 6/202-04). While he did ask what consigned

material was, he did not ask what the collaboration agreements were, nor was he aware of whether DCAA ever made such an inquiry (tr. 6/209-10).

On 14 April 1986, Pratt sent a letter to Mr. Innes that summarized some 17 proposed changes to the 22 August 1984 CAS 418 Disclosure Statement discussed during the 12 March 1986 meeting. The letter makes no reference to Item 4.6.0 (L), collaboration agreements or consigned material. (R4, tab 82)

On 30 June 1986, Pratt submitted an updated version of its NAS Disclosure Statement to Mr. Lawton. Item 2.1.0 continued to refer to collaboration agreements in 4.6.0 and Item 2.2.2 (A) continued to incorporate the "(Rev. 21 – 02/24/84)" version of the Procedure for the Development of Standard Costs (R4, tab 608 at 2, 4 of 68). Item 4.1.0 (n) continued to describe the three separate MOH pools (Purchasing Overhead, Material Handling Overhead, and Vender Quality Assurance Overhead) (*id.* at 29-31 of 68). Item 4.6.0 (C) again listed "Standard Direct Material/Job Order Direct Material" (*id*. at 53 of 68). Item 4.6.0 (L) "Direct Material Cost" was virtually identical to the description provided in the 22 August 1984 CAS 418 Disclosure Statement that had also been incorporated into the 15 May 1985 NAS Disclosure Statement (R4, tabs 605 at 35-36 of 49, tab 606 at 52 of 66, tab 608 at 54-55 of 68). Item 4.7.0 "Application of Overhead and G&A Rates to Specific Transactions or Costs" for the first time listed GFM in subpart c) with material handling overhead, specific administration, and G&A common, but it did not list collaboration material or consigned parts at all (R4, tab 608 at 57 of 68).

Mr. LeClair, who had attended the 8 August 1984 meeting regarding MD's 22 February 1984 CAS 418 Disclosure Statement, was assigned to perform an audit of the 30 June 1986 NAS Disclosure Statement (R4, tab 646 at E-1, tab 769). Next to Item 4.7.0 c), Mr. LeClair's work papers contain the notation: "Does GFM have O/H + G&A" (R4, tab 646 at 57 of 68). A similar question is reflected in the DCAA "SUPERVISORY GUIDANCE/RISK ASSESSMENT" report written by his supervisor and also signed by Mr. LeClair (*id*. at E-1, -3). Pratt answered the question in a 25 August 1986 letter as follows: "Yes, G&A rate is applied to material handling costs (only) not the Government furnished material value" (*id.* at H-4).

At yet another meeting on 14 October 1986, representatives of Pratt, including Mr. Mason, and Messrs. Kelley and Innes of DCAA, met to discuss whether the proposed changes were mandatory or voluntary for the purpose of computing the cost impact due to implementation of CAS 418 (R4, tab 76). Mr. Mason again explained the rationale for changing material overhead from one pool to three separate pools (tr. 4/227). Notes prepared by Mr. Innes report that the rationale was explained as follows:

> . . . In short, the costs for consigned material will get allocations for material handling overhead in all cases and for purchasing overhead in some cases whereas consigned material will not be allocated any vendor quality assurance overhead. All three pools will be allocated to job order material. Mr. Mason said that the allocation to job order material and to consigned material would result in a better measure of the causal beneficial relationship of pool costs and cost objectives.

Mr. Kelley did not recall the meeting, but did agree that DCAA had questioned whether this was a mandatory CAS 418 change. (R4, tab 76 at 4; tr. 4/225-27; Kelley dep. at 102-04)

In a 13 November 1986 memo to Mr. Crowe regarding the drafting of his audit report on MD's 22 August 1984 CAS 418 Disclosure Statement, Mr. Innes summarized the proposed changes with the comment that the direct material base had been expanded to include consigned material cost and that, while there was still some doubt about whether the changes were required or discretionary, they both agreed the changes were discretionary. He concluded that the audit report should state that:

> (a) the change in the material overhead pool to 3 pools is a discretionary, not a mandatory, change.
>
> (b) the addition of consigned material to the direct material allocation base is a discretionary, not a mandatory change.
>
> (c) notwithstanding the opinions in (a) & (b) above, the D[isclosure]/S[tatement] revision does not adequately describe the method by which P & W will estimate the costs to be assigned to consigned material.

(R4, tab 641 at 6486-87; tr. 6/184-88)

Mr. Crowe's draft audit report included Mr. Innes's recommendation. With respect to Item 4.6.0 (L) it also stated with reference to the CAS requirements for "homogeneous indirect cost pools" and "changes in the allocation base:"

> In connection with the fragmentation of the material overhead pool the contractor has established a new category of material referred to as consigned material to comply with CAS 418.

> It is our opinion that the proposed new category of consigned material is not required for purposes of this draft disclosure statement in accordance with CAS 418.50 (b) & (c).

(R4, tab 644 at 5278; tr. 6/189-90) These portions of the draft, as apparently further revised by Mr. Innes, were deleted by Mr. Kelley for reasons that were not explained to Mr. Crowe (tr. 6/19-195). Mr. Kelley did not recall having directed the deletions and could not think of any reason why he would have done so (Kelley dep. at 112-14). Mr. Crowe never told anyone at Pratt to take consigned material out of the allocation base (tr. 6/205).

The DCAA audit report (No. 2640-6D442002) issued on 4 December 1986 for MD's 22 August 1984 CAS 418 Disclosure Statement did not reflect the views discussed by Messrs. Crowe and Innes with respect to the change in the material overhead pool and the addition of consigned material to the allocation base. It made no statement whatsoever about whether the accounting changes were voluntary or mandatory. It did, however, find that while the 22 August 1984 Disclosure Statement had separated the single material overhead pool into three separate pools and expanded the previous allocation base for material overhead to include consigned material, GFM and GPD assist material, it did not adequately describe how the quantities of consigned material and GFM would be determined and the methods to be used to determine the cost associated with this material. (R4, tab 825 at 3) 01-2 BCA ¶ 31,592 at 156,116.

The Approved CAS 418 Disclosure Statement

On 30 June 1987, Pratt submitted a revised MD CAS 418 Disclosure Statement that purported to give consideration to the recommendations contained in the 4 December 1986 audit report. The cover letter stated that Pratt was "withdrawing all previous disclosure statements relating to changes mandated by CAS 418 and submitting herewith a revised disclosure statement, which completely satisfies all CAS 418 requirements." (R4, tab 611 at 1186) Mr. Mason explained that when he stated that Pratt was withdrawing all previous disclosure statements, he meant that the government "could throw them away" (tr. 4/233). The cover letter did not identify any changes relating to collaboration agreements or consigned materials or indicate that these materials had been excluded from the allocation base (R4, tab 611 at 1186).

Item 2.1.0 in the 30 June 1987 Disclosure Statement made no reference to collaboration agreements (*id*. at 3 of 41). Item 2.2.2 (A) continued to incorporate the "(Rev. 21 – 02/24/84)" statement for "Standard Material Cost – Production Effort" (*id*. at 4 of 41). Item 4.1.0 "Overhead Pools and Allocation Bases" (n) "Other Pools" now described only one "Material Overhead" pool (instead of three material overhead

pools) which was to be "[a]llocated to production contracts on a standard direct production material input cost base which includes price/usage variance and vendor tooling, using a standard absorption rate" (*id*. at 15 of 41; exs. A-1, A-3; tr. 4/234). Item 4.6.0 (C) reverted back to "Standard Direct Material/Job Order Direct Material" (instead of only "Direct Material") as an element of the total cost input base (R4, tab 611 at 28 of 41). Item 4.6.0 (L) removed all previous references to collaboration agreements, collaboration material, consigned material, and joint venture and eliminated the matrix depicting the allocation of MOH to collaboration material, GFM and CPD assist material. It again followed the Pre-CAS 418 Baseline Disclosure Statement with a slightly revised description of "Direct Material Cost (Input)" that stated as follows: "The direct material cost base is comprised of standard production direct material, substitution, spoiled work, defective material, price and vendor tooling." (*Id*. at 29 of 41; tr. 4/240-41) Pratt's intention in submitting the 30 June 1987 CAS 418 Disclosure Statement was to reflect Pratt's view "that no accounting changes were required to accommodate the collaboration activity" (tr. 4/237).

DCAA auditor Edward Lecnar was assigned to audit the 30 June 1987 CAS 418 Disclosure Statement (R4, tab 649 at 663). The purpose of the audit was to determine whether the statement adequately described the cost accounting practices that Pratt proposed to use (*id.* at 656). Typically, an auditor who is new to the audit of a CAS Disclosure Statement discusses that statement with auditors who have audited previous statements, and reviews the previous audit reports and workpapers (tr. 6/155-56, 169-71; Kelley dep. at 28-29, 92-93).

Mr. Lecnar had virtually no recollection of the audit he performed (Lecnar dep.). His work papers, however, reflect that he compared the 30 June 1987 Disclosure Statement to the 3 March 1982 Pre-CAS 418 Baseline Disclosure Statement (R4, tab 650). A summary sheet entitled "Comparison of Revised D/S to Existing D/S" contains checkmarks under the "CHANGE" column with a "Yes" for Item 4.1.0, but with a notation that indicates the change was not relevant to the issues in these appeals, and a "No" for Item 4.6.0 (*id.* at 743-49). Mr. Lecnar apparently did not speak to Mr. Crowe (tr. 6/196-97). He did, however, speak to Mr. LeClair, who had performed the DCAA audit on Pratt's 30 June 1986 NAS Disclosure Statement, about the "numerous changes/additions" relating to Item 4.6.0 (L) (R4, tab 650 at 745). There is no evidence as to the substance of their discussion on this issue (Lecnar dep. at 49; LeClair dep. at 154-55). Messrs. LeClair and Kelley also attended several of the meetings Mr. Lecnar held with Pratt (R4, tab 649 at 672). Mr. Kelley had no recollection of any discussions with Pratt at that time about the proposed material overhead and the material allocation base (Kelley dep. at 122). He had a general recollection of discussing with Pratt whether a value for collaboration material would be included in the allocation bases, but did not recall when the discussions took place or the details of them (Kelley dep. at 47-51, 53).

On 15 September 1987, Mr. Kelley advised Mr. Swift, now Chief, Business Management Branch, AFPRO, that DCAA's review of the 30 June 1987 Disclosure Statement "disclosed no inadequacies or noncompliances" (R4, tab 235). On 17 September 1987, Mr. Swift advised Pratt that the Disclosure Statement was "adequate for the purpose of computing the cost impact proposal mandated by the implementation of CAS 418" (R4, tab 62). On 5 October 1987, Mr. Lawton, the ACO, advised Pratt that the AFPRO had determined "the Disclosure Statement to be adequate and in compliance with PL 91-379, as it pertains to the allocation of direct and indirect costs under CAS 418" (R4, tab 61 at 1159). 01-2 BCA ¶ 31,592 at 156,116. Mr. Lawton was not called to testify and no designation of any deposition testimony was offered as evidence.

The Approved NAS Disclosure Statement

On 30 September 1987, Pratt submitted a revised NAS Disclosure Statement with a 1 January 1988 effective date (R4, tab 612). Item 2.1.0 no longer contained a reference to collaboration agreements (*id*. at 3 of 55). Item 2.2.2 (A) "Standard Material Cost – Production Effort" continued to be the "(Rev. 21 – 02/24/84)" version (*id*. at 4 of 55). Item 4.1.0 "Overhead Pools and Allocation Bases" in (n) "Other Pools" identified only one material overhead pool. Item 4.6.0. (L) "Direct Material Cost (Input)" was substantially identical to that contained in the 30 June 1987 CAS 418 Disclosure Statement, but also included "savings, purchase order cancellations and scrap sales" in the base. (*Id*. at 15, 43 of 55) Item 4.7.0 "Application of Overhead and G&A to Specific Transactions or Costs" in (c) listed GFM with material overhead and G&A rates (*id*. at 44 of 55).

The DCAA audit report (No. 2641-8D441002) dated 30 November 1987 and signed by Mr. Kelley found that the changes did not "adequately describe the contractor's revised cost accounting practices in all respects" but that no "discrepancies of CAS noncompliances" were noted (R4, tab 59). The review prompted Pratt to make minor corrections to sheets 20 and 21 of the statement not relevant to the issues in these appeals (R4, tab 613). On 5 January 1988, Mr. Lawton advised Pratt that the Disclosure Statement was adequate and that the NAS was in "total compliance" with CAS (R4, tab 57).

As of 31 December 1986, the balance in the reserve established in 1982 to protect against potential CAS 418 issues exceeded $26,000,000 (R4, tab 945; tr. 6/214). Mr. Walker Grubb was Director of Government Contracting Accounting at UTC during the relevant time period and was responsible for CAS compliance (tr. 6/211-12, 217). He explained that the reserve for CAS 418 was reversed in the fourth quarter of 1987, *i.e.*, it was eliminated and the reserve amount taken to income (R4, tabs 946 through 948; tr. 6/214-15). The reserve was reversed because Part had received "full adequacy and

compliance on [its] CAS 418 and new accounting system disclosure statements and the risk was no longer there. There were no longer reserves required." (Tr. 6/215)

An internal Pratt document that is undated and whose author is unknown, but in context appears to have been prepared after Pratt's Disclosure Statements were found by the ACO to be adequate and compliant following DCAA review, states:

> Initial reserves were established for all changes contemplated as being mandated by CAS 418. Although not specifically monetized, we always considered that "consigned materials" would require being burdened with a Material Handling rate in order to satisfy the "benefits received" concept set forth in CAS 418. Government concurrence with CAS 418 disclosed practices does not preclude a future determination of noncompliance for this issue.

(R4, tab 85; tr. 4/100-01, 6/224-25)

Standard Cost Procedures

On 28 October 1983, Pratt revised its "Procedure for the Development of Standard Costs," effective 1 January 1984, to include "Foreign Collaboration Agreement Parts" in the list of "Purchase and Material Standards" (R4, tab 144). The procedure was first referenced in Item 2.2.2 (A) of the 24 February 1984 CAS 418 Disclosure Statement (R4, tab 605 at 4 of 49). Paragraph II.D.3.j. provided as follows:

> j. Foreign Collaboration Agreement Parts
>
> For those engine programs where a domestic source or where a domestic and a foreign source is available, a domestic standard is utilized.
>
> Where only a foreign source is available, parts are valued utilizing data furnished by the Cost Estimating Section of Manufacturing Engineering Department. This value encompasses material and labor effort required to produce these parts, as if P&WA was to manufacture them. The material and labor costs are then formulated to an estimated purchase part value. This purchased part value is used for standard setting purposes.

(R4, tab 144 at 10683) This was Pratt's procedure for establishing a standard cost for foreign collaboration parts (tr. 5/25). At the time, Pratt still had not received any collaboration parts (tr. 5/24). No changes were made to paragraph II.D.3.j. when revisions were made to the Procedure for the Development of Standard Costs in April 1984 (R4, tab 101 at 11).

Effective 1 January 1987, Pratt further revised its Procedure for the Development of Standard Costs. As is relevant here, the index reference and the title of II.D.3.j were changed from "Foreign Collaboration Agreement Parts" to II.F.5)j. and "Consigned Inventory Parts." The body of II.F.5)j. substituted the words "consigned source" for the words "foreign source." (R4, tabs 77-78)

CPD Pricing Rate Proposals

On 31 January 1986, Pratt submitted to Mr. Lawton a revised forward pricing rate proposal for CPD for 1986 and 1987 prepared by Mr. John Odlum, a CPD cost analyst (R4, tab 795; tr. 8/10). Schedule D-1 of the proposal included separate entries for "MANUFACTURING DIVISION TRANSFER COST" and for "MTU/FIAT COST FOR PARTS" in CPD's G&A allocation base, but excluded MTU/Fiat costs from CPD's input into the Group IR&D/B&P allocation base because Pratt did not perform any research and development for the collaboration parts (R4, tab 795 at 19855; tr. 7/188, 8/33-34, 39). The MTU/Fiat cost was a forecasted value imputed as collaborator revenue share and included in the CPD total cost input base because CPD provided product support and administrative functions for the parts. It was not included in the MD transfer cost because the cost remained with the collaboration partners. (Tr. 7/180, 196-97, 8/15-16, 38-39) Mr. Odlum believed that the government knew from the audits it performed that the MD costs did not include any cost for collaboration parts because the bills of materials and other documentation of the costs did not reflect any collaboration parts (tr. 8/13-14).

On 11 April 1986 DCAA issued an audit report (No. 2640-6E230203) for CPD's 31 January 1986 proposal (R4, tab 804; tr. 8/18). The audit report contained a schedule showing Group's total cost input base, consisting of costs from CPD and GPD, for the allocation of IR&D/B&P (R4, tab 804 at 1477; tr. 8/33). DCAA understood that Pratt was proposing to exclude CPD's MTU/Fiat costs from the Group cost input base and made the following recommendations in the audit report:

> Note 2. CPD IR&D Base
>
> The difference between the proposed and recommended bases is attributable to the inclusion of MTU/Fiat cost input into the IR&D/B&P allocation base. It

> is our opinion that these costs be included as part of the total input costs for CPD, consistent with the 1985 advance agreement.
>
> The contractor stated the MTU/Fiat costs are charged directly to cost of sales (Output) at the time of the applicable engine sale, and are not cost 'input.' In our opinion, all costs are part of the total cost input, whether recorded through an inventory account or charged directly to cost of sales.

(R4, tab 804 at 1478; ex. A-24; tr. 7/190-91, 195, 8/28-32)

An internal Pratt memo written by Mr. Anthony J. DeMarco, a senior financial analyst for government accounting for CPD, describes the following discussion with Mr. R. Horrigan, of the AFPRO, and Mr. R. Gibson, from DCAA, during the 23 April 1986 exit conference regarding the 1986 and 1987 forward pricing rate proposal:

> 1. <u>MTU and Fiat Equivalent Costs in IR&D/B&P Group Allocation Base –</u>
>
> The base used to allocate the IR&D/B&P ceiling between GPD and CPD was adjusted to include equivalent costs of MTU and Fiat bill of material parts. This effectively allocates more of the ceiling to CPD than proposed. DCAA said that this treatment was discussed with John Ford who concurred with these equivalent costs being included in the allocation base. A general discussion ensued whereby, it was brought to DCAA attention that since these parts are developed by and produced by MTU and FIAT, IR&D/B&P is not performed by Pratt and Whitney which could be attributable to these parts. Therefore, no causal/beneficial relationship exists to warrant their inclusion in the allocation process. Conversely, since CPD does, in fact, administers [sic] the sale of the engines that include these parts, it is appropriate to include these costs in CPD's a [sic] G&A allocation base. The DCAA and AFPRO representatives understood these concepts but intended to rely on Ford's Direction.

(R4, tab 805 at 5259; tr. 7/164-65)

Mr. DeMarco testified that he explained to DCAA that the parts were the result of collaboration agreements with MTU and Fiat and that the cost for parts was not transferred from MD to CPD, but that a value had been calculated to represent the approximate cost of the parts for the purpose of allocating G&A (tr. 7/196-97, 201-03, 8/38). Shortly after the exit conference, in May 1986, Pratt gave to Mr. Swift (at his request) a document that contained similar information (tr. 7/204). The document described the composition of Group's base for allocation of IR&D/B&P and the percentage splits to CPD and GPD. It contained separate line items for "MTU/FIAT COST FOR PARTS SUPPLIED" and "MD TRANSFER COST." The MTU/Fiat item has no entry for 1983 because there was no activity and an amount ($22,863) in thousands of dollars entered for 1984. There are no entries for 1985 through 1987 because CPD was not including any value for collaboration parts in the Group IR&D/B&P base. (R4, tab 809; tr. 7/204-08)

On 21 July 1986, CPD submitted to Mr. Lawton its proposed final overhead rates for 1984, which again included a line for "MTU/FIAT COST FOR PARTS" in CPD's combined G&A and IR&D/B&P cost allocation base and reflected an entry of $22,862,594.00 (R4, tab 811 at 1185; tr. 8/53).

On 17 October 1986, CPD submitted a revised forward pricing rate proposal for 1986 and 1987 (R4, tab 822). It contained the same Schedule D cost elements that had been contained in the proposal dated 31 January 1986 and included "MTU/FIAT COST FOR PARTS" in CPD's G&A allocation base, but excluded it from the CPD's cost input into the IR&D/B&P base (R4, tab 795 at 19855, tab 822 at 19885, 19893; tr. 8/40-43). 01-2 BCA ¶ 31,592 at 156,117. DCAA did not comment about the exclusion of the MTU/Fiat parts from the IR&D/B&P base when it audited the proposal (R4, tab 824; tr. 8/43-46).

During 1987, DCAA conducted an audit of CPD's final incurred cost overhead rate proposal for 1984 that had been submitted on 21 July 1986. In an 18 May 1987 meeting, DCAA auditors LeClair and Ms. E. Brady requested information from Pratt about the entry of $22,862,594 for "MTU/Fiat Costs" in CPD's allocation base. Mr. Odlum was asked to document and support the cost (tr. 8/14). He explained to them that the cost represented revenue share, the amount Pratt owed its joint venture partner from the gross revenue from the sale of engines. (R4, tab 811 at 1185, tab 841 at 27478, tab 842; tr. 8/54-61, 115) DCAA confirmed the accuracy of the calculation (R4, tabs 842, 843; tr. 8/76-68). Ms. Brady's notes of the meeting state:

> . . . [J. Odlum] said its [sic] a joint venture whereby parts are made by MTU/FIAT and the $22,862,594 represents the cost of sales for these parts, which is not included in MD's bill of

> material therefore its [sic] not a part of the MD transfer cost, but shown as a separate line for G&A Allocation base [sic].

(R4, tab 841 at 443) 01-2 BCA ¶ 31,592 at 156,117.

The question was repeated in Audit Request No. 12. Pratt's response was that the costs were calculated by multiplying the total sale value of the PW2037 engine by the "MTU/Fiat portion." (R4, tab 844 at 27475-76, 27478) Ms. Brady's notes of a similar inquiry to Mr. Robert Newell in CPD's accounting office on 19 June 1987 record his response as follows: "$22,862,587 [sic] represents the share of sales [Pratt] owes the joint venture" (R4, tab 842 at 3367).

On 1 February 1988, CPD submitted to Mr. Lawton its proposed overhead rates for 1988 (R4, tab 651 at 2732). The proposed G&A allocation base for CPD again included a separate line item amount for "MTU/FIAT COSTS," but again did not include this amount in the Group IR&D/B&P allocation base. The DCAA audit report (No. 2641-8E230001/005), dated 29 March 1988, again questioned the exclusion of the cost from the Group allocation input base. (*Id.* at 2669, 2678-79, 2724) Mr. LeClair's audit notes state: "MTU/FIAT Cost for Parts reflect business activity in the segment and should be included in the input base" (*id*. at 2706, 2747).

CPD Rate Tracking Reports

CPD tracked its actual incurred costs and rates against those projected in its forward pricing rate proposals. This information was provided periodically to the AFPRO, and sometimes DCAA, on a monthly or quarterly basis. (Tr. 8/77-79)

On 4 March 1986, Pratt provided to Mr. Swift the year-to-date calculations to December 1985 for CPD's actual G&A and IR&D/B&P rates that included separate values for "MTU/FIAT COST FOR PARTS" and MD transfer costs in the allocation bases (R4, tab 800 at 387, 393). The year-to-date calculations to March 1986 provided to Mr. Swift on 29 April 1986 also included values for "MTU/FIAT COST FOR PARTS" and MD transfer costs for both bases (R4, tab 806 at 378, 383, 385). On 7 and 16 October 1986, 24 December 1986, and 16 February 1987, CPD submitted to Mr. Swift, with copies to DCAA, the July, August, October, and December 1986 year-to-date G&A and IR&D/B&P overhead rate reports, all of which included a separate cost or value for "MTU/FIAT COST FOR PARTS" in addition to the MD transfer costs (R4, tab 819 at 371, 376, tab 821 at 361, 369, tab 827 at 348, 353, tab 835 at 340, 345).

The record also contains six such reports for 1988 (year-to-date for June, July, August, September, October, and for November and December). All of the reports included line items for "MTU/FIAT COST FOR PARTS" reflecting cost values and MD

transfer costs in CPD's G&A and IR&D/B&P allocation bases. (R4, tabs 872-74, 876-77, 882)

After receiving the report for November and December 1988, Mr. James Mulcahy, an AFPRO cost analyst, inquired about the "MTU/FIAT COST FOR PARTS" line items (R4, tab 882; tr. 8/79-80, 144). Pratt concluded that the entries were inconsistent with its disclosed accounting practices and were in error because they represented revenue shares, not costs. Mr. Odlum, who had prepared the tracking documents, provided this explanation to Mr. Mulcahy, who did not testify at the hearing. (Tr. 8/84-85, 102, 118-19)

Beginning with the March 1989 report, submitted to the government in June 1989, CPD discontinued the line item for "MTU/FIAT COST FOR PARTS" in both its G&A and IR&D/B&P cost input bases. It continued to include MD transfer costs. (R4, tabs 883, 885, 886, 888; 894; tr. 8/81-82)

MD's Rate Proposals

Although MD does not sell engines or spare parts directly to the government, MD does enter into material overhead and G&A forward pricing rate agreements with the government (tr. 8/136-38). Mr. Harold Palin, a senior MD financial analyst testified that he had discussions with the AFPRO, in particular Messrs. Mulcahy and Swift, at various times about the exclusion of "consigned parts and partners" from the direct material base used for development of overhead rates in conjunction with MD's pricing rate proposals and audits, both prior to and after 1 January 1988 (tr. 8/134, 138-40, 153-54).

Starting in May 1985, MD submitted a series of proposals for a new forward pricing rate agreement for 1986 through 1988 (R4, tab 807 at 2985). The 9 December 1985 certified proposal for overhead expenses, including the direct material base for allocating material overhead, was audited by DCAA and analyzed by the AFPRO, principally Mr. Mulcahy (R4, tabs 796, 807; tr. 8/144). Messrs. Swift, as principal negotiator, and Mulcahy and LeClair, among others, participated in the negotiations of the rates on behalf of the government (R4, tab 807 at 2986; tr. 8/141-42). There was evidence that, during these negotiations in March and February 1986, the government was advised that the build up and material cost for the PW-4000, PW2037 and JT8D-200 engines did not include a cost for collaboration parts (ex. A-26; tr. 8/153-54). 01-2 BCA ¶ 31,592 at 156,117.

On 14 March 1986, Pratt and the government entered into a forward pricing agreement for MD's overhead rates for 1986, 1987, and 1988 (R4, tab 801). The agreement did not consider any CAS 418 changes (*id*. at 2953). Another forward pricing

agreement for MD was executed on 7 August 1987 for 1987, 1988, 1989, and 1990 (R4, tab 846). This agreement also did not reflect CAS 418 implementation (*id*. at 2829).

After the NAS was implemented on 1 January 1988, Pratt submitted a proposal to convert the MD 7 August 1987 overhead forward pricing agreement to its revised accounting system (R4, tab 656 at 5468). In the supervisory guidelines for the DCAA audit of this proposal, Mr. Innes wrote:

> An important aspect of this review is testing compliance of the new accounting system to Cost Accounting Standards. This is most critical with respect to CAS 418 because the new system has been implemented to bring [the] old system in compliance with CAS 418 (i.e. we previously cited the old system for a noncompliance with CAS 418).
>
> a. Review the CAS 418 compliance issues previously cited and determine if the new [accounting] system corrects the problems noted in the old system.

(R4, tab 652) The audit report referred to in this note was issued on 4 December 1986 for MD's 22 August 1984 CAS 418 Disclosure Statement (R4, tab 825).

On 26 May 1988, DCAA issued audit report (No. 2641-8D442102), "REPORT ON NONCOMPLIANCE WITH CAS AND FAR," on Pratt's proposal to convert the forward pricing overhead rate agreements to its new accounting system. The report identified three areas of noncompliance, none of which related to collaboration material. (R4, tab 656 at 5468-72)

MD Cost Formula Reports

Mr. Palin explained that Pratt routinely provided to Mr. Kelley the "Actual MD Cost Formula Report #30860," which was used to calculate the total cost input base for allocating G&A expenses (R4, tab 799 at 3066; tr. 8/160-61, 163, 182). The Cost Formula Report for 1985 actual costs includes an item called "ABATED MATL OVHD" but does not reflect any cost accumulation or identify any relationship to foreign collaborations (R4, tab 794; tr. 8/184-85). The Cost Formula Report for 1988 actual costs includes entries for "STD-MATL-CONS" but again reflects no cost accumulation and nothing that specifically relates the entries to foreign collaborations (R4, tab 904; tr. 8/170-75, 185-86). It also has an entry for "OVHD-M-CONSIGNED" that also does not reflect any costs (R4, tab 904). The same appears to be true of the Cost Formula Report for 1989 (R4, tab 905).

Starting in 1989, Pratt submitted forward pricing rate proposals for the period 1989 through 1993 (R4, tabs 892, 893). The DCAA audit work papers for one of these proposals indicates DCAA review of Cost Formula Reports which were forecasts for 1988 through 1992 (R4, tab 653 at 634-41; tr. 8/176-77). During the audit of the 1989 proposal, Mr. Palin explained to Mr. Bob Boyer, a supervisory DCAA auditor, and Mr. Mulcahy that there were no values in the "STD-MATL-CONS" and "OVHD-M-CONSIGNED" items because there had been some contemplation of including values in the NAS, but that the change did not materialize and the computer program had not been changed (tr. 8/177-80). The auditor's work paper notes state: "Allocation bases are in compliance with disclosed practices, i.e. direct and indirect costs for factory machining, factory machine base, factory A&T, material and G&A" (R4, tab 653 at 635). 01-2 BCA ¶ 31,592 at 156,117.

CAS Noncompliance Findings

A new DCAA auditor, Ms. Mariane Hart, was assigned to Pratt's facility in December 1988 and performed various types of audits there until January 1992 (tr. 1/61). In late 1990, she began an audit of a 29 October 1990 revision to the CPD final overhead rates for 1984 previously provided to DCAA on 21 July 1986 and audited by Mr. LeClair and Ms. Brady (R4, tabs 53, 79, 811; tr. 1/74-75). She noted that a document dated 17 September 1990 had removed $22,862,594 for "MTU/FIAT COST FOR PARTS" from both the G&A and IR&D/B&P allocation bases and requested information about the entry (R4, tabs 53, 79, 280, 811; tr. 1/76-77). The explanation provided by either Mr. Odlum or his supervisor, Mr. Dick Shonk, was that the amount should not have been included in the 21 July 1986 submission and represented revenue sharing (tr. 1/77-78). In a subsequent interview, Mr. Odlum explained to her that he had been told to keep the costs out of the base (R4, tab 283; tr. 1/79-80). Notes of an interview with Mr. Shonk, however, indicate that he had agreed to put the costs back into the base (R4, tab 281).

DCAA had orally requested a copy of Pratt's agreement with MTU/Fiat and Mr. Potter, who was once again the DCAA Resident Auditor, renewed the request in writing by a letter dated 16 October 1990 (R4, tabs 279, 283, 285). A copy of the 12 July 1977 agreement was provided by letter dated 19 November 1990 and additional MTU and Fiat agreements were provided in December 1990 (R4, tabs 52, 299; tr. 1/82). Mr. Potter then made a written request for "an explanation of the financial accounting treatment for all items of cost or revenue described in the agreements furnished" (R4, tab 290). Pratt undertook steps to respond to the request (R4, tabs 292, 293). At a meeting called by Mr. Shonk on 13 December 1990 to discuss "the partnership agreements," DCAA requested additional pertinent information and Mr. Shonk responded that the collaboration agreements were "new territory" and that he had researched all possible accounting sources, but had found little advice (R4, tab 294; tr. 1/83-84).

The DCAA audit report (No. 2641-87L14010101) was issued on 28 January 1991. It questioned the removal of the $22,862,594 for "MTU/Fiat Cost for Parts" from CPD's G&A and IR&D/B&P allocation bases for 1984. (R4, tab 48 at 650-51)

On 29 January 1991, DCAA issued another audit report (No. 2641-91L44200001) as a result of the audit of CPD's 1984 final overhead rates (R4, tab 47; tr. 1/85-86). It found noncompliance with CAS 410 and 420 because the "allocation basis [sic] for G&A and IR&D do not include cost associated with MTU and Fiat parts" (R4, tab 47 at 2). 01-2 BCA ¶ 31,592 at 156,117-18. The cost impact of this noncompliance on government contracts for 1984 was estimated to be only $25,761; however, the report went on to note:

> This is a recurring situation which still exists in 1991. Although insignificant in amount for 1984, it should be noted that the amount of MTU and Fiat costs increase each year after 1984. For example, the 1985 amount is $70 million; $171 million in 1986; $219 million in 1987; and $219 million in 1988.

(R4, tab 47 at 3) The audit report further states that Pratt provided the following explanation at the exit conference:

> . . . [T]he MTU and Fiat costs are never booked at P&W. The parts are brought into P&W as consignment inventory, the ownership of which never leaves MTU and Fiat. Consequently, there is nothing to include as P&W activity in the total input base.

(*Id*.)

Initial Finding of Noncompliance with CAS 410 and 420

Mr. Swift, now the Divisional ACO (DACO), notified Pratt of his Initial Finding of Noncompliance with CAS 410 and 420 by a letter dated 12 February 1991. He included a copy of the 29 January 1991 DCAA audit report with his letter. (R4, tab 46; tr. 7/95-96)

The noncompliance finding was discussed at a meeting between representatives of Pratt and the government, including Messrs. Swift and Potter, later that month during which Pratt provided DCAA with a copy of an internal "FINANCIAL COMPLIANCE AUDIT REPORT" dated January 1991 on cost accounting standards and indirect costs (R4, tabs 303, 307; tr. 1/85-88). The report indicated that Pratt's internal auditors had

reached conclusions similar to those reached by DCAA (R4, tab 303; tr. 1/86-87). It noted that MD's MOH was not allocated to any materials supplied by "external parties," *i.e.*, collaborators or the government, that the base did not include any value for "consigned inventory" and that the 30 June 1987 CAS 418 Disclosure Statement determined to be adequate by the ACO described a "single material overhead pool with no allocation to either consigned inventory or GFM" (R4, tab 307 at 2515).

The report found that allocation of MOH and G&A and IR&D/B&P needed to be re-examined with regard to the accounting of commercial collaboration materials, "in particular whether or not consigned inventory represents an input cost" to Pratt. It went on to make a number of suggestions regarding further review; specifically, that a matrix be prepared summarizing the pertinent provisions of the collaboration agreements and that an accounting assessment be made of the implications of the collaboration agreement transactions. (*Id*. at 2517) A copy of such a matrix dated 21 January 1991 was provided to Mr. Potter on 28 February 1991 (R4, tab 309).

An internal Pratt accounting assessment dated 14 May 1991 and titled "COMMERCE COLLABORATION AGREEMENTS SPECIAL CONSIDERATIONS" indicates, among many other things, that "CAS 418 COMPLIANCE" is an advantage of putting collaboration parts in the allocation base and that "REDUCES COST RECOVERY" is a disadvantage (R4, tab 316 at 34525).

On 6 March 1991, Mr. Potter sent a fax to Mr. Swift regarding "CONSIGNED MATERIAL/COLLABORATION AGREEMENTS AND/OR JOINT VENTURES." The fax included the cover letter to and excerpts from Pratt's 22 August 1984 CAS 418 Disclosure Statement with circles around statements in Item 4.6.0 (L) relating to the direct material base. It also included excerpts from the DCAA audit report (No. 2640-6D442002) finding CAS 418 inadequacies, one of which had a hand-drawn box around the report's discussion of "Inadequacy – Allocation Base for Material Overhead Pools." Mr. Swift understood that Mr. Potter was concerned that the issue regarding the allocation base for material overhead might have fallen through the cracks. (R4, tab 920 at 1533; tr. 7/111-12)

Mr. Potter sent Mr. Swift another fax the following day, 7 March 1991, again relating to "CONSIGNED MATERIAL/COLLABORATION AGREEMENTS." The cover sheet identified "HIGHLIGHTS" of "SIGNIFICANT EVENTS" relating to CAS 418 and included Mr. Potter's references to MD's various CAS 418 Disclosure Statements which reflected his view that all of the Disclosure Statements, except that dated 30 June 1987, had treated inclusion of collaboration material in the MOH allocation base as a mandatory change (R4, tab 921; tr. 7/107-09).

Another fax dated 31 July 1991 from Mr. Potter to Mr. Swift establishes that the government was investigating the impact of including both GFM and collaboration materials in the MOH allocation base (R4, tab 949 at 1509-10). Mr. Potter did not testify at the hearing.

In a letter dated 22 July 1991, Mr. Swift complained to Pratt that it still had not provided the information requested by the government regarding the actual accounting treatment of all transactions concerning the collaboration agreements (R4, tab 322). Mr. Nichols responded on 2 August 1991 (R4, tab 324) after which Mr. Swift asked for further information regarding the "inter-relationships between P&W and the various 'partners'" (R4, tab 326). Mr. Nichols responded to the request for further information on 13 September 1991 (R4, tab 33).

Initial Finding of Noncompliance with CAS 410 and 418

On 23 August 1991, Mr. Swift issued an Initial Finding of Noncompliance with CAS 410 and 418. His finding was based upon a 31 July 1991 DCAA "REPORT ON NONCOMPLIANCE FOUND DURING REVIEW OF ANNUAL INCURRED COSTS FOR CALENDAR YEARS 1984 THROUGH 1990" at MD (No. 2641-91D44200804), a copy of which he forwarded to Pratt. (R4, tabs 36, 37) 01-2 BCA ¶ 31,592 at 156,118.

Mr. Nichols disputed the noncompliance finding in a response dated 23 September 1991. He pointed out that both GFM and collaboration material consistently had been excluded from all costs bases under the "premise . . . that Pratt & Whitney did not own/have title to the material and did not control it." He explained that Pratt had considered including both GFM and collaboration material in the MOH and G&A bases as "was fully documented," but that GFM had ultimately been taken out of the CAS 418 Disclosure Statement that was found to be in full compliance. It was his view that GFM and collaboration material should be treated in the same way. (R4, tab 32 at 2, 4)

Mr. Nichols further explained that Pratt had negotiated "drag and/or fixed fee reimbursement percentage" with its partners to provide a reasonable adjustment for indirect costs incurred in handling the parts (*id.* at 3). The drag rates vary substantially, but are intended to reduce Pratt's payments to collaborators in recognition of Pratt's disproportionate indirect program expenses, including overhead for program management and administration, marketing and sales, product support, customer guarantees, warranty and service policies, material handling and other administrative functions (exs. A-5, -7; tr. 3/284-90). 01-2 BCA ¶ 31,592 at 156,111.

On 18 October 1991, Mr. Potter responded to the AFPRO's request for comments on Mr. Nichols' letter. With respect to GFM, his response states in relevant part:

> c. We have been informed by the ACO that GFM had been provided to Pratt & Whitney for the F100 engine program (Nozzles and Jet "A" Fuel). Our limited analyses of available cost accounting data indicate that the inclusion of this GFM in both the material and G&A allocation bases, unlike the impact of including commercial collaboration parts, would not significantly impact the bases or the indirect expenses allocated to Government contracts. However, in the interest of achieving a fair and equitable resolution of the issues, we recommend that GFM be included in these allocation bases.

(R4, tab 29 at 66) It was Mr. Potter's view that DCAA "wouldn't recommend an accounting practice that was not recommended by the CAS" (Potter dep. at 121).

Final Findings of Noncompliance with CAS 410, 418, and 420

On 24 January 1992, Mr. Swift issued his "Final Findings of Noncompliance with Cost Accounting Standards 410, 418 and 420 re 'Collaboration Agreements'" (R4, tab 25). The matters discussed in his findings first came to his attention when he received Pratt's internal "FINANCIAL COMPLIANCE AUDIT REPORT" in February 1991 (R4, tab 45; tr. 7/159-60). His findings state in relevant part:

> 4. This decision was reached after careful review of all the documentation on the issue with the conclusion based on the requirements of the standards and in particular the beneficial or causal relationship between the indirect expenses and the final cost objectives that include these consigned costs. Beneficial or causal relationship is cited in the "Purpose" of all three standards (CAS 418-20, 410-20, and 420-20).
>
> 5. The beneficial or causal relationship with regard to Material Overhead is self evident and has been addressed in your correspondence. In support of the introduction of your revised accounting system that went into effect on 1 January 1988 (but for compliance with CAS 418 was retroactive to 1 January 1982), you discussed including some value of the costs of "Collaboration Agreements and Joint Ventures" in the Material Overhead base. This occurred at least as early as 6 July 1983 and as late as 5 October 1987 but was not accomplished with the introduction of the revised accounting system.

(R4, tab 25 at 2) The "critical element" underlying Mr. Swift's decision was the causal/beneficial relationship between the collaboration parts and Pratt's indirect expense pools, and not whether the parts were "consigned" (tr. 7/116-17). His findings do not specifically address whether GFM should also be included in the allocation bases (R4, tab 25).

He concluded that "the 'revenue shares' of sales cited in all of the 'collaboration' agreements would be the fairest measure" of determining the proper value of the consigned parts and that the period of noncompliance began on 1 January 1984, the approximate date upon which substantial fabrication of the parts began. Finally, he directed Pratt to revise its Disclosure Statements to bring Pratt into compliance with CAS. (R4, tab 25 at 2-3; tr. 7/128-29)

Mr. D. P. Hamilton, Pratt's Vice President of Finance, responded by a letter dated 23 March 1992. He asserted that Mr. Swift's noncompliance findings were:

> . . . [I]ncongruent with the resolution of this issue reached by the parties years ago, and is inconsistent with P&W's CAS Disclosure Statement, which was found adequate and compliant in 1987 after a full consideration of the relevant CAS issues the Government now raises anew.

(R4, tab 23 at 1) The letter went on to state:

> Despite P&W's submission of numerous Disclosure Statement drafts proposing to add consigned material to indirect cost bases, DCAA did not respond until December 4, 1986 with an audit report to the AFPRO. That audit report, which dealt with P&W's first submission (the August 22, 1984 Disclosure Statement), demonstrates that DCAA, and hence the AFPRO, were clearly aware of P&W's proposed treatment of consigned material and GFM. The audit report <u>expressly</u> discussed the change, did not approve the proposed practice, and requested additional descriptive language.

(*Id.* at 2) Mr. Hamilton demanded that the contracting officer issue a final decision finding that its method of accounting for collaboration parts did not violate the CAS standards (*id*.). An appeal was docketed as ASBCA No. 47416. 01-2 BCA ¶ 31,592 at 156,119.

Mr. Swift instructed DCAA to compute the cost impact of the noncompliances and to include GFM in the appropriate allocation bases. DCAA prepared two such audit calculations. (R4, tabs 9, 15; tr. 7/130-31) On 6 April 1993, Mr. Swift issued a "Memorandum of Resolution" based on DCAA's 22 December 1992 audit "Report of Estimated Impact" (No. 2641-93D19500801). He found the exclusion of collaboration parts and GFM from the allocation bases resulted in increased costs to the government of $278,437,240 for the years 1984 through 1994. (R4, tab 2)

Further Noncompliance Findings by the Government

Mr. William Morrow, Jr. replaced Mr. Swift as DACO. On 2 December 1996, Mr. Morrow issued a final decision finding that the collaborators' net revenue share represented a cost to Pratt and should be included in its allocation bases for the calculation of MOH, G&A and IR&D/B&P (R4, tab 375). He found that the collaborators were in essence subcontractors or vendors and that net revenue share payments to them were costs. He defined net revenue share as "gross revenue share less amounts deducted for DRAG credits." (*Id.* at 4) He concluded that the failure to include this cost did not comply with CAS 410, 418 and 420 and increased the overhead rates on government contracts and that the amount due the government, including CAS interest, was $260,290,111 (*id.*). His calculations excluded GFM from the allocation bases, although he did not foreclose the possibility of including it. Like Mr. Swift, he was not concerned about whether the parts were consigned or purchased from suppliers. (Morrow dep. at 76-78; R4, tab 375) 01-2 BCA ¶ 31,592 at 156,119. A timely appeal from Mr. Morrow's final decision was docketed as ASBCA No. 50453 and consolidated with ASBCA No. 47416.

After the CAFC vacated our entitlement decision sustaining ASBCA Nos. 47416 and 50453 and remanded the appeals, Mr. Alan R. Tinti, the new ACO, on 24 November 2003, issued another final decision further updating the government's claim for the period 1984 though 2002, and increasing the amount sought for the CAS 410, 418 and 420 noncompliances to $754,682,517.00, including CAS interest. Mr. Tinti's final decision stated that "the full amount of revenue share payments, sometimes called the 'gross' revenue share payment, constitutes Pratt's cost for the parts 'collaborators' supply to it." He adjusted the cost impact assessed by Mr. Morrow in his 2 December 1996 final decision accordingly in arriving at the new payment demanded. (ASBCA No. 54512, R4, tab 2)

Mr. Grubb was involved in the submission of the 30 June 1987 CAS 418 and 30 September 1987 NAS Disclosure Statements (tr. 6/218). When asked at the hearing whether Pratt would have considered alternative bases, such as a value added base instead of a total cost input base, if the government had insisted in 1987 that collaboration parts were a cost and had to be included in the total cost input base, he

testified that: "We would surely have examined all the alternatives available to us including a value added base" (tr. 6/219). Mr. Loren Stolp was an assistant counsel, senior counsel, associate counsel and finally vice president counsel for CPD during the relevant time period and was involved in negotiating and drafting the collaboration agreements (tr. 3/244-47). He thought that Pratt would have attempted to increase the drag percentages for the existing collaborators if it had been known that the government would insist that gross revenue share be included in the allocation base and "for sure" would have negotiated an increase when a collaborator wanted to buy more shares or was seeking a concession (tr. 3/318-20).

Alleged Government Coercion and Disparate Treatment

On 23 June 1988, Pratt submitted a cost impact proposal in the amount of $49.9 million resulting from changes it alleged had been mandated by implementation of CAS 418. It also submitted a cost impact proposal for a credit to the government in the amount of $8.9 million for voluntary accounting changes associated with the NAS implemented on 1 January 1988, so that the net cost impact was $41 million. The proposal was based upon estimated costs as contained in Pratt's cost formula projections. (R4, tab 866; tr. 7/147-48) The proposal was referred to DCAA on 29 June 1988 (R4, tab 655 at 6265). It was assigned to DCAA auditor Ms. Terri LaPan, under the supervision of Mr. Innes (*id*. at 6268-69). They wanted to return the proposal to Pratt for "corrective action" because of its inadequacies, but Mr. Swift, who was then still the Chief, Business Management, AFRPO, disagreed (*id*. at 6318).

Mr. Swift had an idea on how to reduce the proposed impact amount that he wanted to present to Pratt "along with an explanation of the 'political consequences' of requesting money from the government for the CAS 418 cost impact." He thought he could negotiate a "zero net impact for mandatory and voluntary changes." Mr. Innes thought it was "unusual" for Mr. Swift to want to undertake his own review and that his comment about "political consequences" was out of context in the "government contracting community." (R4, tab 655 at 6315; Innes dep. at 111, 113-14) According to Mr. Kelley, it was not customary for the AFPRO office to find ways to reduce a contractor's cost proposal (Kelley dep. at 141).

Although it is not clear from the record when the conversation occurred, Mr. Swift did discuss the "political consequences" with Pratt, which he explained were that the government commands would not be happy because they would have to come up with more money to pay Pratt for products they had already purchased (tr. 7/153-54). On 18 October 1988, Mr. Swift cancelled the audit because he was "in the process of requesting a new proposal" from Pratt (R4, tab 655 at 6261). On 17 January 1989, representatives of Pratt, the AFPRO and DCAA met to discuss, among other things, the

lack of "auditable supporting documentation" for the cost impact proposal (R4, tab 881 at 5936, 5937).

The proposal was ultimately settled on 8 February 1991 in an agreement that reflects a zero net CAS 418 cost impact. 01-2 BCA ¶ 31,592 at 156,121-22. We denied Pratt's counterclaim in ASBCA No. 50888 which asserted a breach of the 8 February 1991 agreement pursuant to which Pratt had agreed to give up its cost impact claim in exchange for the government's agreement to relinquish any claims for CAS noncompliance relating to the accounting for collaboration materials. *Id.* at 156,133-34. Pratt did not appeal our decision on this issue.

In 1991, DCAA headquarters conducted a survey of 51 joint ventures and other special business units (SBUs) in response to inquiries from its field offices about auditing special contracting entities. The survey concluded there had been "inconsistent application and implementation of the CAS" (R4, tab 329 at 34045). It revised the Contract Audit Manual, issued a "staff conference awareness training package," and requested guidance from the CAS Board on unique contracting arrangements (*id.* at 34040, 34045). 01-2 BCA ¶ 31,592 at 156,120.

DCAA audited the accounting treatment of Special Production Agreements (SPAs) entered into by one of Pratt's competitors, General Electric Aircraft Engines (GEAE). The government did not dispute that the SPAs share key similarities with Pratt's collaboration agreements. In a 1996 audit report on GEAE's revenue share material accounting treatment, DCAA determined that the exclusion of any value for SPA material from its allocation bases did not violate CAS 418 under the circumstances presented. (R4, tab 944 at subtab 12) 01-2 BCA ¶ 31,592 at 156,120. In an audit report issued 18 March 1994, DCAA also found it was proper for Hamilton Standard Division (HSD) to exclude collaboration parts manufactured by Ratier Figeac from its allocation bases under the circumstances presented (R4, tabs 929, 932, 936). 01-2 BCA ¶ 31,592 at 156,120.

DISCUSSION

In its remand, the CAFC observed that Pratt's estoppel argument remained open for decision. It stated:

> A final argument raised by Pratt before the Board was that the government is estopped from contesting Pratt's determination that the revenue payments for parts acquired under the collaboration requirements did not constitute costs. This is said to be so because of the government's prior acceptance of Pratt's treatment of those items. *United Techs.*,

> 01-2 BCA ¶ 31,592, at 53 [sic]. Based on its interpretation of "cost," the Board did not reach this issue. *Id.* This question, therefore, remains open on remand. Adjudication of the estoppel issue must proceed under the "well settled [rule] that the Government may not be estopped on the same terms as any other litigant." *Heckler v. Cmty. Health Servs. of Crawford County, Inc.*, 467 U.S. 51, 60, 104 S.Ct. 2218, 81 L.Ed.2d 42 (1984). Beyond a mere showing of acts giving rise to an estoppel, Pratt must show "*affirmative misconduct* [as] a prerequisite for invoking equitable estoppel against the government." *Zacharin v. United States*, 213 F.3d 1366, 1371, 55 USPQ2d 1047, 1051 (Fed. Cir. 2000) (emphasis added).

United Technologies Corp., supra, 315 F.3d at 1377.

Equitable estoppel is an affirmative defense. *See Foote Mineral Co. v. United States*, 654 F.2d 81, 86 (Ct. Cl. 1981). As the party raising the defense, Pratt bears the burden of proof. *Bridgestone/Firestone Research, Inc. v. Automobile Club de l'Ouest de la France*, 245 F.3d 1359, 1361 (Fed. Cir. 2001).

Pratt argues that established equitable defense principles based upon government conduct and detrimental reliance protect it from retroactive disallowance of its approved accounting for collaboration parts. It relies upon the Court of Claims decision in *Litton, supra*, 449 F.2d 392, and subsequent cases that generally hold that:

> . . . the Government may not disallow retroactively historical costs where the cost or accounting method in question previously has been accepted and approved, the contractor reasonably believes that such acceptance and approval will continue, and the contractor, accordingly, detrimentally relies on these prior acceptances and approvals.

Peat, Marwick, Mitchell & Co., ASBCA No. 29847, 86-2 BCA ¶ 18,915 at 95,400, *citing Gould Defense Systems*, ASBCA No. 24881, 83-2 BCA ¶ 16,676 at 82,981, *aff'd on recons.*, 84-3 BCA ¶ 17,660.

We have previously described the *Litton* retroactive disallowance rule as "a special application of estoppel principles." *Gould Defense Systems*, 83-2 BCA at 82,981. It is a rule "founded on concepts of fairness and equity." *Falcon Research & Development Company*, ASBCA No. 19784, 77-1 BCA ¶ 12,312 at 59,484. As most recently applied at the Board, the rule provides that the government may not retroactively

disallow a cost that it has knowingly and consistently accepted and allowed in the past, with reasonable reliance on the part of the contractor, and must provide proper notice that the cost will be disallowed in the future. *Lockheed Martin Western Development Laboratories*, ASBCA No. 51452, 02-1 BCA ¶ 31,803 at 157,103.

According to Pratt, the *Litton* cases focus upon two essential elements of proof: (1) that the government knowingly approved the contractor's cost accounting practices; and (2) that the contractor relied to its detriment on the government's approval. Pratt adamantly asserts that it is not required to demonstrate affirmative misconduct as an element of its estoppel defense.

The government's view is that we are bound to follow the CAFC's guidance, which includes the application of what it characterizes as "the traditional elements of estoppel," along with the affirmative misconduct element. The traditional elements are: (1) that the government knows the facts; (2) that the government must intend that its conduct be acted upon or act in such a way that the contractor has a right to believe the government so intended; (3) that the contractor is not aware of the true facts; and (4) that the contractor relied upon the government's conduct to its detriment. *See JANA, Inc. v. United States*, 936 F.2d 1265, 1270 (Fed. Cir. 1991), *cert. denied*, 502 U.S. 1030 (1992). *Accord American Electronic Laboratories, Inc. v. United States*, 774 F.2d 1110, 1113 (Fed. Cir. 1985); *Emeco Industries, Inc. v. United States*, 485 F.2d 652, 657 (Ct. Cl. 1973).

Pratt responds that the evidence in these appeals establishes that the government is estopped from retroactively changing its 1987 approvals of Pratt's accounting for collaboration materials under both the traditional elements of estoppel set forth in the *JANA* line of cases as well as the retroactive disallowance standards applied in the *Litton* line of cases. Apart from the contested question of whether Pratt must demonstrate affirmative misconduct, the parties have focused upon the knowing approval and detrimental reliance elements of estoppel and we begin our analysis of whether Pratt has carried the burden of establishing these elements before addressing affirmative misconduct.

What Did the Government Know
About Pratt's Accounting for Collaboration Materials?

Pratt argues that it was clear from the draft CAS Disclosure Statements it submitted from 1983-1986 that it proposed to allocate some portion of its material overhead to consigned material and that DCAA conducted numerous audits during which DCAA had access to whatever information and documentation it considered relevant to the evaluation of Pratt's proposed accounting practice. Pratt further asserts that DCAA also had access to its forward pricing rate proposals, rate tracking documents and

incurred cost reports. From these documents and related discussions, Pratt contends that DCAA learned the significant details about its collaboration program and advised it that allocation of material overhead to collaboration material was not required by CAS 418. Pratt concludes that it followed DCAA's advice and omitted any mention of the consigned material and collaboration agreements in the 1987 CAS 418 and NAS Disclosure Statements and abandoned its earlier proposal to break apart the overhead pool. It asserts that it was clear from the 1987 Disclosure Statements that it was proposing an accounting practice that would exclude collaboration material from the allocation bases for indirect expenses. (App. br. at 15-19)

For its part, the government asserts that it was not aware that Pratt was proposing to exclude costs for collaboration parts from its allocation bases in its 1987 disclosure statements. It contends that it did not know the true nature of the collaboration agreements because Pratt misrepresented that the parts were consigned and had no cost, that it did not take title to the parts, and that the collaborators were partners and/or joint venturers. According to the government, since it did not know the true facts, it could not and would not have knowingly approved Pratt's proposed accounting practice, which would have greatly increased the government's share of overhead expenses. The government contends that the DCAA auditor never advised Pratt, or even hinted to it, that it did not have to include any cost for collaboration parts in its expense pools. It further asserts that, based upon the Pre-CAS 418 Baseline Statement and the 1987 Disclosure Statements, it had no reason to believe that Pratt had decided to exclude any cost from its indirect expense allocation bases. Finally, it contends that Pratt's disclosed practice was to include standard costs for collaboration parts in the allocation base. (Gov't br. at 145-51)

Whether the government knew the facts associated with Pratt's proposed accounting for the materials supplied pursuant to the collaboration agreements when it approved the 30 June and 30 September 1987 Disclosure Statements is a factual question that requires consideration of an extensive record consisting of the CAS 418 and NAS Disclosure Statements and the CPD pricing rate and cost proposals and tracking documents and MD cost formula reports Pratt submitted to the government, together with the many DCAA audits, and the related discussions and correspondence between the parties. At least 11 different DCAA auditors, including supervisory and resident personnel, were involved in the related accounting audit activities. Of these, only Mr. Crowe, who performed the audit of the 22 August 1984 CAS 418 Disclosure Statement, and Ms. Hart, who performed the 1991 audit of the 29 October 1990 revision to CPD's final overhead rates for 1984, were called to testify at the hearing. The excerpts of the deposition transcripts of other auditors received in evidence essentially established that they had virtually no recollection of the events at issue. Mr. Swift's testimony on the knowledge issue provides no evidence of any real import and there was no testimony at

all from Mr. Lawton, the contracting officer who approved the 1987 Disclosure Statements.

Our consideration of this extensive record leads us to conclude that Pratt's argument that it was advised by DCAA in conjunction with the audit of MD's 22 August 1984 Disclosure Statement that CAS 418 did not require it to allocate material overhead to its consigned materials and that it "took to heart" this advice and omitted any mention of consigned material, collaboration agreements or GFM in its 1987 disclosure statements is not supported by the evidence. We also are not persuaded that the government understood that Pratt was proposing an accounting system that would exclude collaboration materials from its incurred cost allocation base for indirect expenses when it approved the 30 June 1987 CAS 418 and 30 September 1987 NAS Disclosure Statements.

The Disclosure Statements

The record reflects that DCAA auditors and AFPRO personnel had learned bits and pieces about Pratt's collaboration program from a variety of sources by the time DCAA issued its 4 December 1986 audit report of MD's 22 August 1984 CAS 418 Disclosure Statement. The government had become generally aware of Pratt's collaboration agreements in the late 1970's, and in mid-1983 was briefed on Pratt's proposed CAS 418 accounting changes, including the development of a NAS for its collaboration agreements and joint ventures. The government's primary interest then, and throughout the initial CAS 418 compliance process, was the cost impact of these accounting changes.

Pratt submitted draft CAS or NAS Disclosure Statements on 30 September 1983, 24 February 1984 (amended on 23 March 1984), 22 August 1984, 15 May 1985, and 30 June 1986 before the government approved its 30 June 1987 CAS 418 and 30 September 1987 NAS Disclosure Statements. These draft statements and the related meetings, discussions and audits provided the government with basic information about Pratt's collaborations with foreign companies to supply commercial engine parts. Accounting for this collaboration agreement material was first described in the 30 September 1983 CAS 418 Disclosure Statement, which stated that the materials utilized only a portion of the MOH pool services and indicated that the allocation base would include an "Abated Material Overhead." Three collaboration programs with Fiat were identified during discussions with DCAA about the 24 February 1984 CAS 418 Disclosure Statement (amended on 23 March 1984), which included a new category of "Consigned Material" as part of the direct material cost input base, the costs of which were to be estimated in accordance with the specific collaboration agreements and/or joint ventures. GFM and GPD assist material were also included in the new "Consigned Material" category.

The 22 August 1984 CAS Disclosure Statement contained a matrix that listed the three programs (PW2037, JT8D-200 and PW-4000) using Fiat collaboration parts, again categorizing the parts as "Consigned Material," along with GFM and GPD assist material. Pratt did not provide details about the collaborations or copies of these, or any other such agreements to the government. Consigned material was included in the direct material cost base and DCAA understood that this collaboration/consigned material was separate and distinct from Pratt's standard production direct material, would expand the allocation base, and would be burdened with Production and Material Handling, but not Vendor Quality Assurance, from three new fragmented MOH pools. The 15 May 1985 and 30 June 1986 NAS Disclosure Statements contained the same description of how Pratt would account for consigned material.

Moreover, it had been agreed that the 22 August 1984 draft statement would be compared to the 3 March 1982 Pre-CAS 418 Baseline Statement. In any event, the evidence established that, during the audit process, Mr. Crowe informally expressed to Pratt his view that its proposed new category of consigned material was not required for CAS 418, and that the three new fragmented material overhead pools and the inclusion of consigned material in the allocation base were voluntary changes that would be subject to downward cost adjustments only. We do not conclude from this evidence that he meant to suggest that the new category of consigned material should be excluded from the base entirely.

The final audit report issued on 4 December 1986 did not make any findings with regard to whether the proposed accounting changes were mandatory or voluntary. Rather, the report simply found that the 22 August 1984 Disclosure Statement had separated the single material overhead pool into three separate pools and expanded the previous allocation base for material overhead to include consigned material, GFM and GPD assist material. It also found that the statement did not adequately describe how the quantities of consigned material and GFM would be determined and the methods used to assign costs to them. It was silent as to whether CAS 418 required allocation of material overhead to consigned materials and GFM.

Neither the 30 June 1987 CAS 418 Disclosure Statement nor the 30 September 1987 NAS Disclosure Statement included the accounting changes relating to consigned materials that had been described in the earlier draft statements. There were no references to collaboration agreements, collaboration material, consigned material, joint ventures, partners, abated material overhead or fragmented material overhead pools because it was Pratt's view that no accounting changes were required to accommodate the collaboration activity.

We are satisfied that the decision to exclude consigned/collaboration material from MD's cost input base for the allocation of material overhead was made by Pratt and was not directed by the government. Mr. Crowe testified without contradiction that he never told anyone at Pratt to take consigned material out of the allocation base and there is no evidence that any other government official ever gave Pratt such a direction. Further, notwithstanding the informal opinion expressed by Mr. Crowe, the 4 December 1986 audit report makes no finding regarding whether the proposed accounting changes were voluntary or mandatory for purposes of CAS 418 compliance. Instead, the report questioned how the quantities and costs for the consigned material and GFM would be determined, a clear indication that the government expected that these materials would be included in MD's direct material allocation base, and not excluded from it.

Other Knowledge

Nor are we convinced that the government otherwise knew that the 1987 disclosure statements were proposing an accounting practice that would exclude collaboration materials from the allocation bases. The cover letter to MD's 30 June 1987 CAS 418 Disclosure Statement withdrew all previous CAS 418 Disclosure Statements. In doing so, it was Pratt's intent that DCAA throw away the previous draft statements and that the 30 June 1987 Disclosure Statement be compared only to the 3 March 1982 Pre-CAS 418 Baseline Disclosure Statement. This was consistent with Pratt's earlier agreement with DCAA regarding the 22 August 1984 Disclosure Statement. Pratt's present argument that DCAA should have considered the information it had learned from its prior disclosure statements is thus inconsistent with these intentions and its agreement.

Pratt attempts to disavow the withdrawal of its previous draft disclosure statements by pointing to the cover letter's reference to the 4 December 1986 audit report and asserting that the new DCAA auditor, Mr. Lecnar, should have noticed that it had dropped the consigned material matrix when he performed the audit of the 30 June 1987 CAS 418 Disclosure Statement. We find nothing persuasive in this argument. The letter makes no mention of any changes in the disclosure statement pursuant to which consigned materials had been excluded from the allocation base, much less that the changes had been directed by the government. Further, the evidence indicates that Mr. Lecnar did have a discussion with the auditor who reviewed the 30 June 1986 NAS Disclosure Statement and was aware that there had been changes to the allocation base. It appears, however, that any comparison he would have made to the earlier draft disclosure statements, would have revealed only that there was no longer a separate category of consigned material that would be burdened with a portion of material overhead.

Significantly lacking is any evidence that anyone from Pratt ever told Mr. Lecnar, or anyone else in the government, that the allocation bases described in MD's 30 June

1987 CAS 418 and 30 September 1987 NAS Disclosure Statements did not include any cost or value for collaboration materials. The statements themselves are too vague and general in this regard to provide such notice. *See FMC Corporation*, ASBCA No. 30130, 87-2 BCA ¶ 19,791, *aff'd*, 853 F.2d 882 (Fed. Cir. 1988).

CPD's Accounting

CPD's documents reflect confused, inconsistent and even contradictory accounting treatment of an entry called "MTU/FIAT COST FOR PARTS." The CPD forward pricing rate proposals submitted on 31 January 1986 and 17 October 1986 included this entry and corresponding values in its G&A allocation base, but excluded the same values from the Group IR&D/B&P cost input base. In conjunction with the audit of the 31 January 1986 proposal, Pratt explained to DCAA that the parts were developed and produced by MTU and Fiat and that the costs were estimated. DCAA noted its disagreement with the proposed practice of excluding the dollar values for "MTU/FIAT COST FOR PARTS" from the Group IR&D/B&P allocation base, but Pratt persisted with the practice in its forward pricing rate proposals. Meanwhile, however, CPD's rate tracking documents continued to include dollar values in the Group IR&D/B&P base for these same parts.

We are of the view that the various CPD accounting entries for "MTU/FIAT COST FOR PARTS" by themselves are insufficient to establish that the government should have known that no cost for collaboration parts was included in the "MANUFACTURING DIVISION TRANSFER COST." There was some testimony that, during the 23 April 1986 exit conference regarding CPD's 31 January 1986 forward pricing rate proposal, a CPD financial analyst explained that no cost for MTU/Fiat parts was transferred from MD to CPD. There was also corroborated evidence that this same information was provided to DCAA in conjunction with the audit of CPD's 1984 final overhead rates in May and June of 1987 when DCAA inquired about the $22,862,594 entry for MTU/Fiat. Neither of these events, however, was related to the audits of MD's CAS 418 and NAS Disclosure Statements, and in particular Mr. Crowe's audit of MD's 22 August 1984 CAS 418 Disclosure Statement. Moreover, the relevant evidence shows only that Mr. LeClair attended the 18 May 1987 meeting and there is no evidence that either Mr. Gibson or Ms. Brady had any prior audit responsibilities or involvement associated with the MD CAS 418 and NAS Disclosure Statements. In short, the information relating to the MTU/Fiat accounting entries was essentially provided to new DCAA auditors who were looking at different accounting issues in a separate organizational unit within Pratt. There is nothing to connect these events relating to CPD to the audits of MD's 22 August 1984 and 30 June 1987 CAS 418 Disclosure Statements or its 30 September 1987 NAS Disclosure Statement.

Further, it was not until March 1989 that CPD's accounting for "MTU/FIAT COST FOR PARTS" was actually eliminated from its G&A and IR&D/B&P allocation bases. And, as we have observed, although there were discussions in April 1986 and May and June 1987 about the MTU/Fiat parts, the record does not reflect whether the information obtained by the auditors was used in any way that should be imputed to either Mr. Lecnar or the contracting officer in conjunction with the audit and approval of MD's CAS 418 Disclosure Statement. *Compare Gould Defense Systems, supra*, 83-2 BCA at 82,982.

There was some additional uncorroborated testimony that Pratt told the government during negotiations for a new forward pricing rate agreement for MD in February and March 1986 that the cost of the engines being built in collaboration with Fiat did not include the cost of collaboration parts. This, again, was not in the context of the 22 August 1984 CAS 418 Disclosure Statement and the agreement ultimately reached did not consider any possible CAS-related accounting changes. MD's Cost Formula Report for 1985 appears, at best, to reflect the draft disclosure statements' accounting approaches Pratt was considering at the time.

Finally, Pratt has not provided any explanation as to what additional information the DCAA auditors would have obtained had they asked for copies of the collaboration agreements, as it asserts they should have. To the extent there was information in the agreements that was relevant to the government's determination of its compliance with the new CAS 418 standard, it was Pratt's responsibility to make this information available. *See PACCAR, Inc.*, ASBCA No. 27978, 89-2 BCA ¶ 21,696 at 109,079.

In *Litton*, the court observed that all of the relevant circumstances were to be examined in determining whether a change in a contractor's accounting practices should be retroactive. *Litton, supra*, 449 F.2d at 399. The peculiar facts there reflected "long and consistent use of the cost of sales method with the Government's knowledge, approval and acquiescence." *Id.* at 401. As our discussion makes clear, the relevant circumstances and peculiar facts in these appeals are substantially different from those in *Litton*. The record here does not satisfy the *Litton* criteria, irrespective of whether the decision is characterized as one based upon the cost principles, as the government asserts, or one based upon estoppel as Pratt asserts, because the government did not know that no value or cost for collaboration materials had been included in Pratt's allocation bases when it approved the 1987 disclosure statements. Pratt has not carried its burden of demonstrating here that the government should be charged with the kind of knowing approval and acquiescence that was present in *Litton* and is similarly required as a traditional element of estoppel by *JANA*.

"Procedure for the Development of Standard Costs"

Nevertheless, we also conclude that there is no merit to the government's contention that the cost of the collaboration materials was incorporated into the allocation base via the "Procedure for the Development of Standard Costs." The procedure was first referenced in Item 2.2.2 (A) of the 24 February 1984 CAS 418 Disclosure Statement and included "Foreign Collaboration Agreement Parts" in its list of "Purchase and Material Standards," effective 1 January 1984. The title was changed to "Consigned Inventory Parts" and minor editorial modifications were subsequently made, effective 1 January 1987. The CAS 418 and NAS Disclosure Statements approved in 1987 both included the 24 February 1984 version of Item 2.2.2 (A).

We find no record support for the proposition that either Pratt or the government ever considered this procedure as providing the method for including a standard cost for collaboration parts in the allocation base during the relevant time period. On the contrary, the 24 February 1984 CAS 418 Disclosure Statement (amended on 23 March 1984) explained in Item 4.6.0 (L) that the estimated value is consistent with the terms of the specific collaboration agreements and/or joint ventures. And, as we found, the DCAA auditor understood that the collaboration/consigned material was different than Pratt's standard production material. In this regard, the 4 December 1986 audit report of the 22 August 1984 CAS 418 Disclosure Statement remarks that the methods used to determine the cost of consigned material, GFM and CPD assist material were not adequately described. In any event, even if the audit report could possibly have been referring to the standard cost procedure, the government could not have approved the 1987 disclosure statements without resolving the adequacy issues. *See* FAR 30.202-6.

Legal Consignment

Finally, we find nothing persuasive in the government's reliance upon the CAFC's decision that the collaboration materials "did not qualify as legal consignments" to support its assertion that it did not know the true nature of the collaboration agreements. *See United Technologies Corp.*, *supra*, 315 F.3d at 1373. The government was not confused or misled by Pratt's description of the parts as having been consigned, or by Pratt's description of the collaborators as partners or joint venturers. It is clear from the disclosure statements and related discussions that the materials were identified as having been supplied under collaboration agreements, irrespective of what words were used to describe the parts and the suppliers. The CPD forward pricing rate proposals and tracking documents all used the words "MTU/FIAT COST FOR PARTS," not the word "consigned," to describe these same items.

Nor do we consider Pratt's grouping of collaboration materials with GFM and CPD assist material to be misleading, either with respect to any cost to Pratt or the

transfer of title. The government was aware that Pratt was considering using an estimated value for consigned material and that it had included a separate line item for "MTU/FIAT COST FOR PARTS" in CPD's combined allocation base for G&A and IR&D/B&P that reflected a value of nearly $23 million for 1984. Of considerable significance in this regard is the lack of evidence establishing that either DCAA or the contracting officers ever considered whether the materials were legally consigned to Pratt as part of the government's review and approval of Pratt's disclosure statements, or in 1992 and 1996 when the government found that Pratt's accounting practices for collaboration parts were not compliant with CAS 410, 418, and 420.

Did Pratt Rely to its Detriment upon the Government's Approval of its 1987 CAS 418 and NAS Disclosure Statements?

Pratt asserts that it did what is routine and required under the FAR when the government approves a contractor's disclosed accounting system—it followed its disclosed and approved practice of excluding any value for collaboration material from its indirect expense allocation bases, and therefore allocated no overhead to material received from its collaborators. It also asserts that this impacted its pricing of cost-based government contracts, its negotiation of "drag" and other collaborator expenses, and its decision to forego investigation of other alternative accounting methodologies, in particular value-added accounting, for the allocation of G&A expenses.

The government responds that Pratt's arguments are not supported factually, legally, or even hypothetically and should be rejected (gov't resp. at 178-82). The government's first contention is that Pratt did not follow its disclosed practice, *i.e.*, that standard costs for collaborator parts were to be included in the allocation base. We reject this argument inasmuch as we found above that there was no merit to the government's underlying contention that standard costs for collaboration parts were included in the base via Item 2.2.2 (A) of the disclosure statements.

Next, while Pratt is correct that the detrimental reliance testimony relating to the negotiation of drag was unrebutted, the evidence is speculative in nature. Whether Pratt would have considered alternative accounting methodologies, such as the use of a value-added cost input base, and undertaken a study of the causal/beneficial relationship between G&A expenses and material and subcontract costs, is likewise speculative. Moreover, the government correctly asserts that Pratt had every opportunity to initiate and complete a study at the time it was considering other alternative methods of accounting for collaboration parts, such as were proposed in the 30 September 1983 and the 22 August 1984 CAS 418 Disclosure Statements.

There was evidence that Pratt's reserve of $26 million to protect against potential CAS 418 issues was released after Pratt received approval of its 1987 Disclosure

Statements. We are not persuaded that the release of these reserve funds establishes detrimental reliance upon the government's approvals, in particular in light of the subsequent memorandum that concluded that the government's concurrence with its CAS 418 Disclosure Statement did not preclude a future determination of noncompliance of its accounting for consigned material.

Pratt's final argument is that under *Litton* and its progeny, in particular *Sanders Associates, Inc.*, ASBCA No. 15518, 73-2 BCA ¶ 10,055 and *Falcon Research & Development Co.*, ASBCA No. 19784, 77-1 BCA ¶ 12,312, detrimental reliance is presumed when a contractor has both fixed-price and cost-reimbursement contracts and the government has retroactively disallowed overhead allocation. The government did not respond to this contention. Had we concluded that the government did approve Pratt's 1987 disclosure statements with knowing acquiescence that the cost of collaboration parts had been excluded from the allocation bases, it seems likely the *Litton* presumption would apply. *Cf. Broad Avenue Laundry and Tailoring v. United States*, 681 F.2d 746 (Ct. Cl. 1982) (contractor required to comply with contracting officer's action within the scope of authority even though it was erroneous).

Does the Affirmative Misconduct Element Apply in these Appeals?

Pratt strenuously contends that the affirmative misconduct element of estoppel against the government does not apply in these appeals. It asserts that, because the Board had not decided estoppel and the issue was not before the CAFC on appeal, the court's "gratuitous statement" regarding affirmative misconduct is not part of the mandate. It further asserts that the court's affirmative misconduct dicta is inconsistent with the *Litton* line of cases and the tenet that the government should be treated no differently from a private litigant when it is acting in its proprietary capacity as a contracting party. Pratt concludes that the CAFC may have overlooked *Litton* and could not have intended to overrule it "*sub silentio*." (App. br. at 24-25) The government responds that, as part of its mandate, the CAFC simply provided guidance to the Board on the necessary elements of estoppel against the government that correctly included the requirement that Pratt establish affirmative misconduct on the part of the government.

We agree with Pratt that the CAFC's comments about the elements required to establish equitable estoppel, and in particular the application of the affirmative misconduct standard, were not necessary to its decision regarding CAS compliance and could be characterized as dictum. *See In re McGrew*, 120 F.3d 1236, 1238 (Fed. Cir. 1997). Further, the comments had nothing to do with the merits of the estoppel defense and are not the law of the case, a doctrine limited "to issues that were actually decided, either explicitly or by necessary implication, in the earlier litigation." *Toro Co. v. White Consolidated Industries, Inc.*, 383 F.3d 1326, 1335 (Fed. Cir. 2004). Similarly, the CAFC's denial of Pratt's motion for rehearing or rehearing en banc and the Supreme

Court's denial of its petition for certiorari have no precedential value with respect to our consideration of estoppel. *See Barber v. Tennessee*, 513 U.S 1184 (1995); *Exxon Chemical Patents, Inc. v. Lubrizol Corp.*, 137 F.3d 1475, 1479 (Fed. Cir. 1998). However, inasmuch as Pratt did address the *Litton* case in its Petition for Rehearing or Rehearing en Banc, Pratt's contention that the CAFC may have overlooked it is not correct.

Pratt next argues that the cases cited by the Supreme Court in *Office of Personnel Management v. Richmond*, 496 U.S. 414 (1990), as giving rise to the affirmative misconduct element involved circumstances in which allowing the estoppel defense would have conflicted with an explicit Congressional direction and that no such conflict exists here. *See INS v. Hibi*, 414 U.S. 5, 8 (1973) and *INS v. Miranda*, 459 U.S. 14, 19 (1982) (enforcement of immigration laws); *Schweiker v. Hansen*, 450 U.S. 785, 788 (1981) (enforcement of compliance with regulations for distribution of welfare benefits). It points out that, in *Burnside-Ott Aviation Training Center, Inc. v. United States*, 985 F.2d 1574, 1581 (Fed. Cir. 1993), the CAFC considered the *Richmond* decision in the context of government contracting and concluded that the *Richmond* holding was not so broad that "equitable estoppel will not lie against the government for any monetary claim." Relying principally upon *Mobil Oil Exploration & Producing SE, Inc. v. United States*, 530 U.S. 604, 607 (2000) and *United States v. Winstar Corp.*, 518 U.S. 839, 895 (1996) (plurality opinion), Pratt asserts that the affirmative misconduct standard conflicts with the tenet that the government must be treated the same as a private litigant when acting in its proprietary capacity as a contracting party.

In *Richmond*, a disability benefit claimant sought to estop the government from finding him ineligible for benefits because he relied upon the erroneous advice of a government employee. The Court began its analysis of the estoppel issue by observing that "[f]rom our earliest cases, we have recognized that equitable estoppel will not lie against the Government as it lies against private litigants." *Richmond*, 496 U.S. at 419. As the CAFC observed in its remand, it is "well-settled that the Government may not be estopped on the same terms as any other litigant." *United Technologies Corp., supra*, 315 F.3d at 1377, *quoting Heckler v. Cmty. Health Servs. of Crawford County, Inc.*, 467 U.S. 51, 60 (1984).

The *Richmond* Court went on to observe that: "Despite the clarity of [its] earlier decisions, dicta in our more recent cases have suggested the possibility that there might be some situation in which estoppel against the Government could be appropriate." *Richmond*, 496 U.S. at 421. It commented that the proposition had taken on "something of a life of its own" and that its decisions "continued to mention the possibility, in the course of rejecting estoppel arguments, that some type of 'affirmative misconduct' might give rise to estoppel against the Government." *Id*. Although it acknowledged that it had reversed every finding of estoppel by the courts of appeals presented to it, and despite the

"substantial" arguments advanced by the government, the Court ultimately refused to "embrace a rule that no estoppel will lie against the Government in any case." *Richmond*, 496 U.S. at 423. Instead, it narrowly held that estoppel was not available in that case because the claim was "for payment of money from the Public Treasury contrary to a statutory appropriation." *Id.* at 424. The Court specifically declined to address whether there were any "extreme circumstances that might support estoppel in a case not involving payment from the Treasury." *Richmond*, 496 U.S. at 434. As is apparent, the *Richmond* decision expresses the Court's strong view against permitting estoppel against the government absent some form of affirmative misconduct or extreme circumstances.

The CAFC first addressed *Richmond* in the context of a contract case in *JANA* where it questioned whether estoppel was still available against the government, but ultimately decided the case on "contract precedent prior to *Richmond*" without applying the affirmative misconduct element. *JANA*, 936 F.2d at 1270. *Burnside-Ott* was the next contract case in which the CAFC addressed *Richmond.* There, the contractor sought to prevent the government from denying a claim based upon a Department of Labor determination that it had improperly classified its employees. The CAFC reversed the Court of Federal Claims' conclusion that the contractor's equitable estoppel defense was barred as a matter of law, stating, as Pratt points out, that *Richmond* was not so broad that "equitable estoppel will not lie against the government for any monetary claim." It did not, however, discuss the affirmative misconduct element. *Burnside-Ott*, 985 F.2d at 1581.

In *Zacharin v. United States*, 213 F.3d 1366 (Fed. Cir. 2000), the CAFC observed that the *Richmond* "Court has suggested that if equitable estoppel is available at all against the government some form of affirmative misconduct must be shown in addition to the traditional requirements of estoppel." The CAFC went on to make clear that, like all of the other courts of appeals, it has held that "affirmative misconduct is a prerequisite for invoking equitable estoppel against the government." *Zacharin*, 213 F.3d at 1371. While *Zacharin* was not a contract case, it did involve actions by the government that were of a proprietary or business nature inasmuch as the underlying issue involved whether the government was required to reimburse appellant for its use of a patented invention.

The CAFC subsequently cited both *Burnside-Ott* and *Zacharin* in *Frazer v. United States*, 288 F.3d 1347 (Fed. Cir. 2002). *Frazer* asserted breach of contract claims against the government stemming from the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and its implementing regulations. At issue was whether equitable relief from the statute of limitations was warranted. With respect to equitable estoppel, the CAFC recited its *Burnside-Ott* interpretation of *Richmond* as holding that "the precise circumstances under which a claim of equitable estoppel is available against the United States are not completely settled." *Id.* at 1353. It

went on to cite *Zacharin* for the same proposition cited in the remand; namely that "equitable estoppel requires affirmative government misconduct." *Id*. at 1354.

Most recently, the CAFC affirmed our application of the affirmative misconduct element of estoppel against the government in a CDA contract case in *United Pacific Insurance Company*, ASBCA Nos. 52419 *et al*., 04-1 BCA ¶ 32,494 at 160,745. Citing *Zacharin*, the CAFC again stated: "Our own precedent dictates 'that if equitable estoppel is available at all against the government some form of affirmative misconduct must be shown in addition to the traditional elements of estoppel.'" *United Pacific Insurance Co. v. Roche*, 401 F.3d 1362, 1366 (Fed. Cir. 2005) (citations omitted).

Mobil Oil and *Winstar*, in contrast, were breach of contract cases, neither of which involved estoppel against the government. In *Winstar*, the Court expressed concern that to allow the government to avoid contractual liability by passing a regulatory statute would "flout the general principle that, 'when the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.'" *Winstar*, 518 U.S. at 895, *quoting Lynch v. United States*, 292 U.S. 571, 579 (1934). It found a breach of contract when the government failed to indemnify savings and loan associations for losses occasioned by changes in the contract terms imposed by subsequent legislation. *Mobil Oil* quoted *Winstar* for this same general contract law principle along with Restatement of Contract repudiation principles to "help the reader understand the significance of the complex factual circumstances" of the case. *Mobil Oil*, 530 U.S. at 607. The Court concluded there that the government breached and repudiated lease contracts with two oil companies and applied common law rules of restitution.

The estoppel issue in the appeals pending before the Board arises in the context of the government's performance of contractual duties in conjunction with CAS rules and regulations, namely the review and approval of CAS Disclosure Statements pursuant to FAR 30.202-6 and enforcement of CAS compliance pursuant to FAR 30.202-7. These governmental regulatory rights and obligations are not applicable to contracts between private litigants, and certainly not in the context of equitable estoppel. We find no inherent conflict between the Court's application of general contract law principles in the *Mobil Oil* and *Winstar* cases and the CAFC's guidance regarding the Court's continued reluctance to apply specific equity principles underlying estoppel against the government reflected in *Richmond*. The equitable estoppel guidance provided by the CAFC in its remand here is the same as the equitable estoppel rule it applied in *Frazer*, a *Winstar*-related breach of contract case. With these considerations in mind, we decline to read *Mobil Oil* and *Winstar* so broadly as to exclude the government's contractual acts in these appeals from the affirmative misconduct requirement of equitable estoppel.

We, therefore, will follow the guidance provided by the CAFC in deciding the estoppel issue in these appeals and require that appellant demonstrate some form of affirmative misconduct by the government, just as we did with the CAFC's approval in *United Pacific Insurance Company*, *supra*, 04-1 BCA at 160,745. *See also, RGW Communications, Inc. d/b/a/ Watson Cable Company*, ASBCA Nos. 54495, 54557, 05-2 BCA ¶ 32,972 at 163,335, *Kearfott Guidance & Navigation Corp.*, ASBCA Nos. 49271 *et al.*, 04-2 BCA ¶ 32,757 at 162,023-24, *recons. denied*, 05-1 BCA ¶ 32,845. In this regard, we note that the United States Court of Federal Claims has also required a showing of affirmative misconduct to establish estoppel against the government in contract cases. *See, e.g., Die Casters International, Inc. v. United States*, 67 Fed. Cl. 362, 383 (2005); *General Electric Co. v. United States*, 60 Fed. Cl. 782, 797 (2004); *DeMarco Durzo Development Co. v. United States*, 60 Fed. Cl. 632, 637-38 (2004); *Ervin and Associates, Inc. v. United States*, 59 Fed. Cl. 267, 297 (2004), *aff'd*, 120 Fed. Appx. 353 (Fed. Cir. 2005); *Capital Properties, Inc. v. United States*, 56 Fed. Cl. 427, 436 (2003).

Was there Affirmative Governmental Misconduct Here?

The CAFC has not discussed the standards against which we are to measure the affirmative misconduct element of estoppel against the government. Pratt relies upon *Watkins v. United States Army*, 875 F.2d 699, 707 (9th Cir. 1989), *cert. denied*, 498 U.S. 957 (1990), in asserting that "[t]here is no single test for detecting the presence of affirmative misconduct; each case must be decided on its own particular facts and circumstances." It emphasizes the mutuality inherent in contract cases and contractors' reliance upon the authorized actions of the contracting officer.

Pratt points to *General Elec. Co.*, *supra*, 60 Fed. Cl. at 799, as an example of a CAS case in which the evidence did not support a finding that the government "affirmatively misled" the contractor because it had not changed its position on the application of CAS 413. It contends that, in contrast, the government in these appeals affirmatively took the position in 1987 that Pratt's method of accounting for collaboration material complied with CAS 418 and that it was "affirmatively misled" into relying upon that view. It concludes that, in a contractual setting, this is sufficient to meet the affirmative misconduct standard.

Alternatively, and in addition, Pratt asserts that the government did not fairly and impartially apply the CAS requirements because it reversed its prior approvals and applied the same analysis it had previously rejected in order to maximize its financial position and because it has treated Pratt differently than its competitors with respect to collaboration materials.

The government relies upon *Melrose Associates, L.P. v. United States*, 45 Fed. Cl. 56, 60 (1999), in which the court summarized the views expressed in a number of other court decisions before concluding that it did not appear that the government official in question acted "in bad faith or recklessly, with an intent to injure the plaintiff, or with knowledge of the true facts." It views Pratt's proposed "affirmatively misled" test as being the same as the detrimental reliance element of estoppel.

We cited *Melrose* for the proposition that a demanding definition of affirmative misconduct was appropriate in *RGW Communications, supra,* 05-2 BCA at 163,335, in the context of granting the government's motion to dismiss. While we have no reason to depart from that view, we do not believe that the determination of affirmative misconduct should be made by routine application of a composite test that seeks to cover all eventualities. Nor do we agree with the government that Pratt's proposed "affirmatively misled" test is the same as detrimental reliance. Rather, we consider the *United Pacific*, *Frazer* and *Zacharin* decisions to be instructive in evaluating the affirmative misconduct element of equitable estoppel.

In *United Pacific*, the CAFC affirmed our finding based on undisputed evidence that there was no affirmative misconduct where the government made unintentional mathematical errors. *United Pacific, supra*, 401 F.3d at 1366. In *Frazer*, it concluded that there was no affirmative misconduct on the part of the government associated with appellant's failure to initiate its *Winstar*-related action before the six-year limitations period expired. *Frazer, supra*, 288 F.3d at 1354. In *Zacharin*, the court concluded that the government's failure to call the plaintiff's attention to possible legal consequences of his contractual actions did not constitute affirmative misconduct where there was no evidence that the government had given the plaintiff incorrect legal advice or made any misrepresentations with regard thereto. *Zacharin, supra*, 213 F.3d at 1371-72.

Hanson v. Office of Personnel Management, 833 F.2d 1568, 1569 (Fed. Cir. 1987) is also instructive. There, the CAFC accepted the Merit Systems Protection Board's finding that affirmative misconduct was not present because the government's representations regarding a retirement annuity were made in full good faith on the basis of accepted interpretation of the applicable statute.

Applying the guidance provided by these cases, we conclude that the actions to which Pratt points do not constitute affirmative misconduct on the part of the government. First, contrary to Pratt's contention, the government did not find that Pratt's method of accounting for collaboration material complied with CAS 418 in 1987. On the contrary, we concluded above that the decision to exclude consigned/collaboration material from its allocation bases was made by Pratt and was not directed by the government and that the government did not know that Pratt was proposing to exclude these materials from its bases when it approved the CAS 418 and NAS Disclosure

Statements in 1987. Pratt, therefore, was not affirmatively misled into relying upon the government's approval and the government's reversal of its approval was not unfair.

Further, there is no factual basis for Pratt's argument that the government found a way to protect its industry-wide policy to exclude GFM, thus yielding a windfall. When Pratt submitted its 22 August 1984 CAS 418 Disclosure Statement, it was the government's industry-wide practice to exclude GFM from indirect cost input allocation bases (app. br. at 48; gov't resp. at 193). Pratt, nevertheless, included GFM in its definition of consigned material in that, and other disclosure statements. Thus, the exclusion of consigned material from Pratt's allocation bases also resulted in the exclusion of GFM, the effect of which was simply to return the accounting for GFM to the industry-wide practice. As we concluded above, this was Pratt's decision, not a ploy by the government to protect a policy that yielded a windfall.

Pratt next speculates that the government was focused upon the bottom line in 1992 when Mr. Swift issued his final noncompliance findings and had concluded that excluding both collaboration parts and GFM was to its financial disadvantage because of the ever-increasing value of the collaboration material. The question before us however, is whether there was affirmative misconduct in 1987 when the government approved the disclosure statements, not in 1992. *See Hanson, supra*, 833 F.2d at 1569. *See also, Henry v. United States*, 870 F.2d 634, 635 (Fed. Cir. 1989).

In any event, the impact of excluding the collaboration parts was first addressed in the 29 January 1991 DCAA audit report of CPD's 1984 final overhead rates. During the course of his evaluation, Mr. Swift solicited the views of both DCAA and Pratt with respect to whether both GFM and collaboration material should be included in the allocation base. Pratt, through Mr. Nichols, responded that both should be treated the same way. DCAA, through Mr. Potter, responded that GFM, unlike collaboration parts, would not significantly impact the allocation bases, but that both should be included "in the interest of achieving a fair and equitable resolution of the issues" (R4, tab 29 at 66).

Mr. Swift's findings do not specifically address whether GFM should be included in the allocation bases, much less whether there is any basis for disregarding the government's policy of not allocating material overhead to GFM. Whether this policy complies with the CAS 418 causal/beneficial relationship requirements is not an issue we are asked to decide in these appeals. Rather, Mr. Swift focused upon the accounting treatment of collaboration parts and the "critical element" underlying his 24 January 1992 final findings of noncompliance was the causal/beneficial relationship between the collaboration parts and Pratt's indirect expense pools. The facts simply do not support Pratt's contention that Mr. Swift based his decision upon an evaluation of the financial benefit to the government resulting from retraction of its prior approval of the 1987 CAS 418 and NAS Disclosure Statements. On the contrary, we are satisfied that his decision

was based upon the government's first real understanding that Pratt's accounting practice was to exclude collaboration materials from its allocation bases.

And, while Mr. Morrow's 2 December 1996 findings that the collaborators were subcontractors and that the revenue share payments were costs did have the effect of excluding GFM from the allocation bases, there again is no evidence that these findings were the result of any affirmative misconduct on the part of the government. At best, they represent the government's continued evaluation of the CAS 418 accounting issues associated with the collaborations. Further, like Mr. Swift's findings in 1992, and, as the government points out, Mr. Morrow's findings in 1996 are of questionable relevance inasmuch as they was not issued until many years after the events Pratt relies upon for its estoppel defense.

Lastly, we cannot say on this record that the government did not follow applicable principles of consistency and uniformity in its treatment of Pratt and its competitors. The CAFC has already addressed Pratt's contention that it was inequitable to require it to account for collaboration parts when a competitor was given different treatment. It held: "That a defense contracting official may have reached a contrary result based on similar facts does not bind the government or this court." *United Technologies Corp., supra*, 315 F.2d at 1377. We conclude from the foregoing statement that any contrary results that may have been reached by the government with respect to other contractors based upon the circumstances applicable there do not establish affirmative misconduct here.

CONCLUSION

We find no merit to appellant's estoppel and related equitable defenses to the government's claims. Consistent with the CAFC's decision in *United Technologies Corp., supra*, the appeals in ASBCA Nos. 47416, 50453 and 54512 are denied as to entitlement. The matters are returned to the parties to negotiate quantum.

Dated: 12 May 2006

CAROL N. PARK-CONROY
Administrative Judge
Armed Services Board
of Contract Appeals

(Signatures continued)

I concur

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

I concur

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

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA Nos. 47416, 50453, 54512, Appeals of United Technologies Corporation, Pratt & Whitney, rendered in conformance with the Board's Charter.

Dated:

CATHERINE A. STANTON
Recorder, Armed Services
Board of Contract Appeals