ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Lockheed Martin Corporation	)	ASBCA No. 54169
	)	
Under Contract No. N00030-96-C-0097	)	

APPEARANCES FOR THE APPELLANT: James J. Gallagher, Esq.
Kevin J. Slattum, Esq.
McKenna Long & Aldridge LLP
Los Angeles, CA

APPEARANCES FOR THE GOVERNMENT: E. Michael Chiaparas, Esq.
Chief Trial Attorney
Arthur M. Taylor, Esq.
Deputy Chief Trial Attorney
Defense Contract Management Agency
Carson, CA

OPINION BY ADMINISTRATIVE JUDGE PEACOCK

This appeal involves issues related to the treatment and measurement under Cost Accounting Standard (CAS) 409.50 and FAR 31.205-16 of losses resulting from sales by appellant of six parcels of land and buildings in Sunnyvale, California. Both entitlement and quantum are before us for decision.

FINDINGS OF FACT

1. The referenced contract was awarded to Lockheed Martin Corporation (LMC or appellant) by the United States Navy on 14 May 1996. The parties have selected this flexibly-priced contract as a representative and appropriate vehicle for presenting the issues in dispute which concern the indirect costs allocable to appellant's contracts in connection with sales of six parcels of land and buildings. (R4, tab 1) The contract incorporated FAR 52.216-7, ALLOWABLE COST AND PAYMENT (JUL 1991), FAR 52.230-2, COST ACCOUNTING STANDARDS (AUG 1992) and FAR 52.230-5, ADMINISTRATION OF COST ACCOUNTING STANDARDS (FEB 1995) (*id.* at 149, 153).

A. The Sunnyvale Property Acquisitions

2. In January 1954, Lockheed Aircraft Corporation (LAC) established Lockheed Missile and Space Division (LMSD). The new division was formed to design, develop and produce guided missiles, satellite vehicles and perform other space-related programs. (SOF ¶¶ 1, 2)[1] On 1 November 1955, LAC purchased approximately 276 acres of land in Sunnyvale, California and constructed manufacturing and related buildings thereon for the purpose of developing a complex to support LMSD (SOF ¶ 2). Sunnyvale is located approximately 40 miles south of San Francisco and 15 miles north of San Jose, California in an area that is known as Silicon Valley (tr. 1/78; app. supp. R4, tab 66).

3. In late December 1956, LAC sold approximately 83 acres of the improved Sunnyvale property to Prudential Insurance Company (Prudential). Prudential agreed to complete construction of unfinished buildings. In January 1957, Prudential leased the 83 acres and newly constructed buildings back to LAC under a 25 year lease agreement. In December 1981, LAC repurchased the land previously sold to Prudential and all buildings that had been constructed thereon before and during the term of the lease. (SOF ¶¶ 3-5)

4. Between 1983 through the end of the third-quarter of 1998, LAC and its successors in interest (ultimately appellant LMC) enlarged the Sunnyvale complex through acquisitions of adjacent properties. As of the end of the third-quarter 1998, the complex consisted of a total of 580 acres of land and buildings. (SOF ¶¶ 7-11) Each of the buildings consists of hundreds of components that were placed into service at various times (tr. 3/160; app. supp. R4, tab 65 at 55-161). The total cost of the buildings was $198,939,953 (R4, tab 61 at 2-3).

B. Downsizing/Consolidation and Excess Capacity/Idle Facilities

5. In March 1995, Lockheed Corporation and Martin Marietta Corporation merged to form appellant LMC (tr. 2/84; app. supp. R4, tab 129 at 2).

[1] The parties have executed a Stipulation of Facts (SOF) setting forth agreed facts which the Board has referenced by paragraph number in our Findings. The parties have also used a continuous sequential numbering system in supplementing the Rule 4 file rather than each creating separately numbered files. We refer to the Rule 4 number without distinction as to whether the document was added by appellant or the government. References to page numbers in Rule 4 are generally to bates numbers, if available.

6. In approximately 1994, in recognition of declining defense business, Congress passed legislation directed at corporate restructuring to permit the resulting costs and savings to be amortized over a five year period (tr. 2/158-59). LMC was the first corporation to enter into one of the newly authorized Restructuring Advance Agreements ("RAA") (*id.*; app. supp. R4, tab 129).

7. Following the merger, LMC continued to suffer a reduction in its business base and loss of major competitive contract award decisions (tr. 1/80, 179; app. supp. R4, tab 130, section 1, summary at 5). LMC reduced the employee headcount at its Sunnyvale facility by over 5,000 employees between 1997 and 2000 (tr. 1/98-99; R4, tab 130 at 6). The headcount was approximately 8,000 lower in 2000 than had been forecast in 1996 (*id.*).

8. Between March to August 1998, DCAA auditors from its Silicon Valley Branch Office toured LMC's Sunnyvale and nearby Palo Alto, California facilities. On 25 February 1999, DCAA issued an audit report assessing the "economy, efficiency and effectiveness" of appellant's "Facilities Management Operations." (App. supp. R4, tab 131 at 2491-92) The report stated that DCAA had toured the LMC Sunnyvale facilities in March to August 1998 and found that LMC "has an abundance of vacant or underutilized space in many of its buildings that, with proper planning, could be used or consolidated to significantly reduce facility costs" (app. supp. R4, tab 131 at 2498). It confirmed that LMC had experienced a substantial reduction in headcount from 1990 through 1999 (from over 20,000 employees in the Bay Area to approximately 6,000-7,000) (app. supp. R4, tab 131 at 2503). The audit report concluded that LMC "could realize annual savings of about $6.6 million, of which $4.7 million would be allocable to government contracts, if it increased space utilization by pursuing opportunities to vacate or sublease leased buildings and to sell or close underused owned buildings" (*id.*). The report also noted that LMC's headcount "has been decreasing much faster than its building square feet" and that "it remains clear that [appellant] has not reduced its total building square feet relative to its headcount" (*id.* at 2503). If appellant failed to act on its recommendations to reduce facilities costs through lease terminations and building sales, the report stated that DCAA "will, as a minimum, question the costs as being unreasonable in accordance with FAR 31.201-3" and "may also recommend the contracting officer reject future pricing submissions which include the effects of identified, inefficient or uneconomical practices" (*id.* at 2494).

C. The Dot-com Boom and Silicon Valley Real Estate Price Escalation

9. Sunnyvale is located in the heart of the Silicon Valley, known for its concentration of high technology companies (tr. 1/28; R4, tab 63 at 2988). The LMC facilities border the Silicon Valley's "Golden Triangle." At the end of the third quarter of 1998 (just prior to the sales of the six parcels in dispute here), LMC's complex

encompassed 580 acres. Economic forces transformed the Sunnyvale area from a manufacturing and agricultural-based economy to one based on services and technology (R4, tab 63 at 2987-88, 2991-92; SOF 10).

10. In the late 1990s, the Santa Clara County Valley Transportation Authority extended the Light Rail Transit ("LRT") Tasman line in the area adjacent to the six parcels of land that are the subject of this dispute (referred to by the parties and herein as the subject properties) (R4, tab 63 at 2990, 2992). The LRT-Tasman line that serviced the subject properties was placed into service in 1999 (*id*. at 2984, 2990). A station was located at Lockheed Martin Way and at other locations within Moffett Park—the Sunnyvale business park which encompassed the LMC facilities. (*Id*. at 2990).

11. The Silicon Valley real estate market is "particularly volatile" because it tracks the rapidly evolving high tech industry and, as that industry has evolved, the real estate business has evolved (tr. 2/16). Through the years, the Sunnyvale/Silicon Valley real estate market has changed from single story warehouse needs to mid-rise office buildings (tr. 2/17-19). In the late 1970s and early 1980s, the high tech companies were manufacturing chips and personal computers; they required one story buildings with office space in the front, assembly and manufacturing space in the middle, and warehouse space at the back of the buildings (tr. 2/18). By the mid-1980s, these firms had moved their manufacturing operations overseas and high tech companies then evolved into software developers. The software developers desired two-story buildings with offices on the second story and warehouse and assembly space on the first floor (tr. 2/18). By the mid-1990s, the type of buildings again evolved to three and four story offices and increasing to five and six story buildings by 2006 (tr. 2/18). By that time the high tech companies no longer manufactured, assembled or warehoused in the Silicon Valley because it had become too expensive (tr. 2/19, 204-06; *see also* R4, tab 63 at 2988). This evolution to multi-story buildings increased land values in the area (tr. 2/19-20).

12. The dot-com boom caused a rapid rise in real estate prices (tr. 2/21-22, 204-06; app. supp. R4, tab 192 at 9). The emerging dot-com companies needed space-often within three to six months; their time frame was much shorter than the typical two-year period it took developers to complete the acquisition, zoning, designing and building processes (tr. 2/23).

13. The dot-com boom peaked from 1998 to 2001, during which time internet companies and developers required land for new, large-scale corporate development in the Silicon Valley, which had a shortage of available land because the area was "near full build-out" (tr. 2/17, 204-06; R4, tab 63 at 2988, 2992, app. supp. R4, tab 192 at 9). The high tech companies that drove the dot-com boom preferred multi-story office buildings with employee amenities including substantial window coverage to provide natural light into work areas (tr. 2/18-19, 204-06; app. supp. R4, tab 192 at 9).

14. Land prices track both rents and the available building square footage (tr. 2/19-20). The higher the density (*i.e.*, the amount of square feet that can be built on a parcel), the higher the corresponding land value (*id.*). Land prices rise with the rents, but, if rents are low and cannot provide a reasonable return for the cost of development, land becomes "illiquid" (tr. 2/20).

15. Floor area ratio (FA ratio) represents the amount of building square footage that may be constructed on a given parcel of land. For example, a 100,000 square foot parcel of land with a FA ratio of 50% permits construction of a building(s) with up to 50,000 square feet. The higher the FA ratio, the greater the allowable building space and the more valuable the underlying land because a developer could realize greater lease revenues from the property. (Tr. 1/92-94, 97-98, 2/209)

16. With the advent of the LRT in the area, the City of Sunnyvale began to increase the available FA ratio for properties adjacent to the LRT, including the subject properties, which, prior to the redevelopment had an approved FA ratio of 35% (tr. 1/92-94, 2/209-11; R4, tab 63 at 2984, 2992, tab 192 at 11). In fact, the City of Sunnyvale approved eight projects in Moffett Park from 1999 to 2001 and seven of them obtained at least 50% FA ratio, with the one exception receiving a 44% FA ratio allowance (tr. 2/211-12; R4, tab 63 at 2995, app. supp. R4, tab 192 at 12). Increases in the FA ratios enabled construction of multi-story buildings and new, larger scale corporate development (R4, tab 63 at 2992).

17. The types of buildings discussed in this case fall loosely into three classes—Class A, B, and C in order of descending quality. Class A buildings at the time of the events in dispute were modern, three to four story, steel framed office buildings with extensive glass/windows. Class B buildings were older generally concrete tilt up, two story facilities, with substantially fewer windows and assembly/warehouse space on the ground floor. Class C buildings were one story, concrete tilt up structures with limited window space. (tr. 2/32).

18. The rent level for Class A buildings in the area was about $.50 per square foot in the 1994-95 time period rising to $5.25 for a project leased in 2000 (tr. 2/20-21). The Silicon Valley rent market changed rapidly again following the dot-com "bust" in 2001. During the dot-com demise, rental rates on Class A buildings fell from over $5.00 to about $1.25 per square foot in some cases, and no potential lessees were interested in renting Class C buildings (tr. 2/33). Mr. Norm Hulberg, an expert in real estate appraisal and President of Hulberg Associates, the largest appraisal firm in the Silicon Valley area, also presented data that showed that office/R&D rents for Class A buildings in Silicon Valley had peaked at about $5.00 per square foot in late 2000 and early 2001 and then dropped to approximately $2.50 by the middle of 2002 (tr. 2/207-08; app. supp. R4, tab

192 at 10). Prior to this sharp decline, Mr. Hulberg testified that the LMC Sunnyvale property was right in the epicenter of the hottest market in his 30 years of real estate appraisal experience in the Silicon Valley (tr. 2/206; app. supp. R4, tab 192 at 10).

D. The Sales

19. In 1997, LMC renewed its efforts to dispose of excess facilities in Sunnyvale (tr. 1/82-89). During the period 1998 through 2001, LMC sold six parcels of land/facilities that are the subject of this dispute. The net sales proceeds received by LMC for all six parcels were $313,760,128. The entire cost of the buildings and improvements constructed on the properties was $198,939,953 and at the time the sales were completed their net book value was $80,020,275. (SOF ¶¶ 5, 12) The six parcels of land are referred to collectively by the parties and herein as the "subject properties" (as noted above) and the buildings as the "subject buildings." With two exceptions, the subject properties are identified by the building numbers on the parcels sold and are, in order of sale, Parcels: 560/561; North 40; 177/178; 104/105; 562; and, 8. A number of particulars are common to all of the sales.

20. The final sales terms and price in each transaction resulted from arm's length, good faith bargaining by the parties (tr. 1/75, 2/197-98; app. supp. R4, tab 192 at 4). There is no contention that the sales agreements did not accurately reflect the intent of LMC and the various buyers of the properties. Nor is there any contention that the decisions to sell the properties for the amounts involved were unreasonable business decisions by LMC (tr. 4/16-17).

21. The facilities on the six parcels sold were Class C buildings. With limited exceptions, the buildings were generally one story, undistinguished, concrete, tilt-up with limited windows, most of which were constructed between 1955 and 1980. The estimated remaining service lives of the buildings were substantial and all of the buildings had insurance valuations. The costs of necessary modifications to the buildings to make them ready for lease to potential lessees (other than LMC) would have been substantial. Modifications would have been required to meet asbestos, earthquake and construction code requirements on certain buildings. (Tr. 1/95-96, 143, 146-47, 150, 161-63, 2/31-33, 201-03, 4/37-39; SOF ¶ 12; R4, tab 9, app. supp. R4, tabs 68, 69, 89, 106, 109, 110-118)

22. LMC received more than two dozen offers for the six parcels and none of the prospective purchasers intended to retain the existing buildings. The buyers of each of the parcels paid nothing for the buildings. In accordance with the express terms of the sales agreements, the buildings/improvements on the six parcels were to be demolished immediately before or shortly after the sales in order to redevelop the land. With the exception of the North 40 parcel, the sales agreements required the buyers to pay the

demolition costs. Each of the sales agreements specified that the properties were sold "as is" with no repairs. With the exception of Parcels 177/178 and 8, all buildings/improvements were demolished shortly before or after consummation of the sales and vacation of the buildings by LMC personnel. (Tr. 1/100-03, 136-41, 143, 154-55, 159,164, 201, 2/53-57, 4/27-28; R4, tabs 7, 8, 10, 11, 18, 24, 25, app. supp. R4, tabs 72, 76-79, 81, 85, 86-87, 95-104, 108, 119, 120-122)

23. All of the purchasers/developers intended to construct multi-story, light-filled, glass and steel, Class A office buildings for the use of high technology companies (tr. 1/46-47, 96-98, 116-20, 129, 144, 2/30, 39-40, 45, 51, 55-63; app. supp. R4, tabs 71, 76, 92, 108, 123-127, 162).

24. The City of Sunnyvale was encouraging development along the LRT and there was a "high probability" that an increase to the permissible FA ratios would be authorized (tr. 1/90-94, 2/26-29, 35-39; app. supp. R4, tabs 70, 72). After the sales, all of the purchasers were successful in obtaining substantial increases in the FA ratio ranging from 50% to 65% (tr. 2/35-36, 1/144, 2/49-50; app. supp. R4, tabs 70, 75, 90, 107, 123).

25. In accounting for each of the sales, LMC allocated the entire net proceeds to the land and treated the remaining NBV of the depreciable assets (buildings/improvements) as a loss on disposition, with the amount of the loss included in its overhead accounts either in the year of sale or amortized over a five year period (tr. 2/89, 3/86; SOF ¶ 12; R4, tab 19, app. supp. R4, tab 130).

26. With respect to the North 40 sale, beryllium contamination was discovered in the soils under Building 170 on the parcel. LMC was required to remediate and "decommission" the building by federal and city authorities. In the sales agreement, LMC agreed to demolish all of the improvements (including Building 170) as the first step in a "two phase" closing. (Tr. 1/102, 108-09, 111-16; R4, tab 8, app. supp. R4, tabs 81, 82)

27. The sale of Parcel 177/178 was completed by 28 September 1999. On that date, LMC leased back both buildings to allow time to transition out of the facilities. The base term of the lease for one building ended on 30 June 2000 and the other on 31 December 2000. (R4, tab 17) LMC did not exercise options to extend the term. After LMC moved out of the buildings, the buyer (Menlo Equities) planned to demolish them and redevelop the land for Yahoo. Yahoo, however, asked Menlo Equities to delay redevelopment temporarily. Pending commencement of redevelopment, Menlo Equities attempted to lease the buildings but was unsuccessful in finding a lessee. At the request of the City of Sunnyvale and as a gesture of goodwill, Menlo Equities permitted a local automobile dealership to use the parking lots for "overflow" storage of vehicles until the buildings were demolished. The dealership agreed to make a donation of $1,000 per

month to a local charity in this interim period. The buildings were demolished in October 2001. (Tr. 1/127-29, 2/42-45, 77; R4, tabs 10, 17, app. supp. R4, tab 128; SOF ¶ 12)

28. Prior to marketing Parcel 104/105, LMC obtained an appraisal of the two buildings by Carneghi-Bautovich & Partners, Inc. (CBP) in March 1999. The CBP appraisal concluded that Parcel 104/105 was worth more as unimproved land than with the buildings. (R4, tab 9) CBP stated that the "existing building improvements are not considered functional in the current market (*id.* at 14). It also concluded that the "highest and best use" of the parcel was "demolishing the existing building improvements and redevelopment . . ." (*id.* at 16). The buildings contained lead-based paint and PCB ballast (App. supp. R4, tab 89) and the sales agreement for the parcel also required LMC to "decommission" the buildings prior to completing the sale (R4, tab 11 at § 8).

29. LMC's offering circular for Parcel 8 contained a proposed lease back agreement for 11 buildings that would, among other things**,** give LMC up to 12 months to make an orderly move out of the building and relocate employees (tr. 1/150-54; app. supp. R4, tab 119 at 3645, 3675). The parcel was sold to a joint venture Menlo/Juniper Networks LLC (MJN) in January 2001. As part of the sales agreement, LMC and MJN entered into a lease agreement for the 11 (Parcel 8) buildings. Menlo proceeded to obtain regulatory approval of a plan to demolish existing improvements and construct Juniper Networks' "world headquarters" containing ten new office buildings, a hotel and related structures to include 2.4 million square feet of office/research and development facilities to be built over a ten year period. (Tr. 1/164-65, 2/63-66; R4, tab 25; SOF ¶ 12) Final approval of the plan was obtained in May 2002 (tr. 160-64; app. supp. R4, tab 123). Between the time of the sale to MJN and approval of its redevelopment plan, the "dot-com" bubble burst, the Silicon Valley real estate market experienced a "total turn around," the need for the planned facilities declined and a decision was made by MJN to delay commencement of development (tr. 1/161, 166, 2/64-65). As a result of the delay, MJN & LMC entered into several amendments and extensions of the lease arrangements. The first amendment extended the lease for four of the 11 original buildings for about five months and three buildings for one year; the other four building had been vacated. (Tr. 1/168; supp. R4, tab 315) The second amendment extended the lease for three buildings (109, 113 and 118). A third lease amendment extended the terms for the latter three buildings and permitted LMC to use parts of two other buildings for temporary warehouse and office space. A fourth extension of the lease term was executed for the three buildings. As of the hearing date, LMC continued to use the buildings. (Tr. 169-70; supp. R4, tabs 317, 318).

30. On 15 March 2000 shortly after the sale of Parcel 562 (the fifth sale) in February 2000 and in anticipation of the (sixth and final) sale of Parcel 8, LMC submitted a proposed Advance Agreement/Memorandum of Understanding to the

government offering to amortize the projected losses from those dispositions over five years rather than charging the entire amount of the losses in the year of the sales. LMC was particularly concerned that the potential loss from the Parcel 8 sale (the approximately $40 million NBV of the improvements) was much higher than any of the other sales and would distort its overhead rate. The intent of the proposed advance agreement was to reduce the impact of the loss in any one year. The cover letter proposed that the losses from the sales be treated as a mass or extraordinary disposition. The proposed agreement did not suggest that the losses be remeasured, merely that they be spread over multiple accounting periods. No agreement was reached by the parties on the request. (Tr. 2/111-12, 137-39, 4/48, 56-57; R4, tabs 20, 30; app. supp. R4, tab 130)

E. Assessed Tax Value of Subject Properties

31. The Santa Clara County Tax Assessor's Office assessed the value of the Sunnyvale Property land and improvements for real property tax purposes at various times relevant to this appeal (SOF ¶¶ 13-14).

32. Just prior to and subsequent to the merger between the Lockheed Corporation and the Martin Marietta Corporation in March 1995, the Santa Clara County Tax Assessor's Office assessed the value of the Sunnyvale Property's improvements and land as follows:

PROPERTY	IMPROVEMENTS		LAND	
	Before Merger	After Merger	Before Merger	After Merger
560/561 Parcel	$ 9,607,038	$ 9,722,059	$10,975,633	$11,061,027
North 40 Parcel	$22,858,178	$24,391,206	$ 1,564,643	$ 1,564,643
177/178 Parcel	$10,150,875	$ 7,072,052	$ 4,596,823	$ 4, 651,525
104/105 Parcel	$28,780,839	$24,730,946	$ 9,127,708	$ 9,236,328
562 Parcel	$ 3,669,964	$ 2,835,997	$ 4,228,232	$ 4,278,548
Parcel 8	$97,362,354	$88,133,994	$27,350,401	$27,675,870

(SOF ¶ 13)

33. Just prior to and subsequent to their sales, the Santa Clara County Tax Assessor's Office again assessed the value of the Sunnyvale Property's improvements and land as follows:

PROPERTY	IMPROVEMENTS		LAND	
	Before Sale	After Sale	Before Sale	After Sale
560/561 Parcel	$ 1,776,926	*	$ 9,085,946	$ 18,500,000

North 40 Parcel	$ 11,562,560	*	$16,681,574	$ 35,647,138
177/178 Parcel	$ 2,151,545	$0	$ 5,763,211	$ 12,484,800
104/105 Parcel	$ 30,552,419	*	$18,501,816	$ 40,670,000
562 Parcel	$ 207,644	*	$ 5,010,557	$ 11,575,000
Parcel 8	$111,000,868	$1,000	$57,609,903	$135,349,000

(SOF ¶ 14)

34. The buildings on Parcels 560/561, North 40, 104/105 and 562 had been demolished prior to the issuance of the first Santa Clara County tax assessment following the sale of each of those parcels (SOF ¶ 14).

35. The Santa Clara County Tax Assessors' policy is to assign all the property's value to the land when the property's buyer expresses an intention to demolish the improvements (SOF ¶ 14).

F. Applicable FAR and CAS Provisions

36. The version of FAR 31.205-16, GAINS AND LOSSES ON DISPOSITION OR IMPAIRMENT OF DEPRECIABLE PROPERTY OR CAPITAL ASSETS, applicable to the issues in this case provided:

> (a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation or amortization applicable to those assets was included. . . . However, no gain or loss shall be recognized as a result of the transfer of assets in a business combination (see 31.205-52).
>
> (b) Gains and losses on disposition of tangible capital assets, including those acquired under capital leases (see 31.205-11(m)), shall be considered as adjustments of depreciation costs previously recognized. <u>The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds from involuntary conversions, and its undepreciated balance.</u> The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost (or for assets acquired under a capital lease, the value at which the leased asset is capitalized) of the asset and its undepreciated balance (except see subdivisions (c)(2)(i) or (ii) below).

> . . . .
>
> (e) <u>Gains and losses arising from mass or extraordinary sales, retirements, or other disposition other than through business combinations shall be considered on a case-by-case basis.</u>
>
> (f) Gains and losses of any nature arising from the sale or exchange of capital assets other than depreciable property shall be excluded in computing contract costs.
>
> (g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be allowed for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environment damage, idle facilities arising from a declining business base, etc.). [Emphasis added]

37. CAS 409, DEPRECIATION OF CAPITAL ASSETS, at CAS 409.50(j) covers gains or losses on dispositions of depreciable assets as follows:

> (j)(1) Gains and losses on disposition of tangible capital assets shall be considered as adjustments of depreciation costs previously recognized and shall be assigned to the cost accounting period in which disposition occurs except as provided in subparagraphs (j)(2) and (3) of this subsection. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds in the event of involuntary conversion, and its undepreciated balance. However, the gain to be recognized for contract costing purposes shall be limited to the difference between the original acquisition cost of the asset and its undepreciated balance.
>
> . . . .
>
> (3) The contracting parties may account for gains and losses arising from mass or extraordinary dispositions in a manner which will result in treatment equitable to all parties.

(App. supp. R4, tab 214)

G. The Dispute, Claim and Appeal

38. Mr. Anthony DiPasquale served as LMC's Corporate Director of Government Financial Management and later Vice President of Government Financial Management during the time period encompassing these sales. Mr. DiPasquale worked for LMC and its predecessor corporation for thirty-six years in positions such as chief of financial planning, director of financial planning and director of government finance relations. He served a four-year term on the Cost Accounting Standards Board ("CASB") and has extensive experience and service in the areas of government contract costs and financial management. (Tr. 2/92-97)

39. Mr. DiPasquale approved LMC's accounting treatment of the sales. He considered that where either the buyer demolished the property after the sale or the seller demolished the property before the sale, all of the sales proceeds were for the land alone with no value being attributed to the buildings by the buyers. Mr. DiPasquale considered that the proper accounting treatment for each sale was to allocate the sales proceeds to the land and write-off the entire net book value (or NBV) of the buildings/improvements as a loss. (Tr. 2/87-90)

40. On 30 June 2000, DCAA issued an audit report concluding, among other things, that appellant inequitably accounted for the sales under the mass/extraordinary disposition provisions of CAS 409.50(j)(3) by allocating all sales proceeds to the land and writing the entire net book value of the buildings off as a loss (R4, tab 23).

41. At a meeting in July 2000, appellant was questioned by DCAA concerning the propriety of allocating the entire proceeds of sale to the land. In particular, DCAA considered that the governing provisions should be FAR 31.205-16(e) and CAS 409.50(j)(3) rather than FAR 31.205-16(b) and CAS 409.50(j)(1). LMC maintained its position that the losses first were required to be measured in accordance with the formula prescribed in FAR 31.205-16(b) and CAS 409.50(j)(1). Appellant asserted that the measurement formula in both provisions required that the loss on disposition of each building was net book value because no "amount" was paid for the buildings. According to appellant, this conclusion was supported by: the terms of the transactions; the intent and actions of the parties with respect to demolition and redevelopment before and after the sales; the CBP appraisal of Parcel 104/105 corroborating that at least the buildings on that parcel had no value in the real estate market at the times of their sale; and post sale real estate tax assessments and treatment by the purchasers allocating no value to the buildings after the sales. Appellant considered that the provisions of CAS 409.50(j)(3) and FAR 31.205-16(e) permitted the parties to reach agreement on *assigning* the losses over multiple accounting periods but only after first *measuring* the amount of the loss in accordance with the formula in CAS 409.50(j)(1) and FAR 31.205-16(b). At the meeting, DCAA also considered that other pre-sale "value" measures should be used

(including pre-sale tax assessments and NBV of the buildings) to measure the loss. (Tr. 2/89-100, 109-11; app. supp. R4, tab 165 at 1436-41, 1448-49)

42. On 18 April 2001, the Division Administrative Contracting Officer (DACO) at the DCMA Lockheed Martin Sunnyvale Office made an initial finding that LMC was noncompliant with CAS 409, referencing the reasons given in DCAA's 30 June 2000 audit report (R4, tab 27). [2]

43. On 11 May 2001, DCAA issued an audit report on appellant's Fiscal Year (FY) 1999 incurred cost proposal. The audit questioned LMC's claimed losses in connection with the North 40 and 177/178 claimed parcels. (R4, tab 28)

44. In a reply of 18 June 2001 disputing the DACO's initial finding of noncompliance, LMC stated, the "Government apparently proposes that we ignore indisputable information about the value of the properties at the time of their sale" and asserted that it was only when evidence about demolition of the buildings "is lacking, we determine relative value of the land and buildings via independent appraisal" (R4, tab 29 at 2).

45. On 22 October 2001, the DACO issued a Notice of Intent to Disallow Costs (Notice) associated with the sales of the North 40 and 177/178 parcels. The Notice stated that appellant was "required to make adjustments if there are any significant variances from the anticipated service life/residual value; absent any adjustments, the [NBV] is considered to be the agreed upon correct representation of actual value" (R4, tab 39 at 2). The DACO considered that LMC had elected a "clearly inequitable treatment" by proposing that the entire NBV of the buildings be treated as a loss/cost on disposition (*id.* at 3).

46. By letter dated 14 February 2002, the DACO disallowed costs resulting from LMC's claimed losses on sales of the subject properties from November 1998 through January 2001. Among other things, the DACO maintained that the buyer's intent should not dictate cost allowability. (R4, tab 41) The DACO also stated that "[t]here is no doubt that the buildings had value when they were sold and that the sales prices were much higher than the [fair market value] of the land alone" (*id.* at 6-7). He noted that evidence of such "value" included LMC's use of the buildings prior to sale, insurance and assessed tax valuations, and the lease back of some buildings (*id.).*

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[2] The sales in dispute in this appeal originally included certain sales of appellant's land and facilities in Austin, Texas. The parties settled their disputes regarding the Austin property sales prior to the hearing of the appeal. Therefore, we have confined our findings and discussion herein to the Sunnyvale sales.

47. On 31 July 2002, the DACO unilaterally established appellant's billing rates for FY 2001 in accordance with FAR 42.704, resulting in a decrement of approximately $2.7 million to LMC's proposal to account for potentially unallowable costs associated primarily with the claimed losses on the sale of the North 40 and 177/178 parcels (tr. 3/229-31; R4, tabs 49, 52).

48. On 14 November 2002, LMC submitted a certified claim in the amount of $1,946,093 requesting that the DACO issue a final decision and alleging that the portion of the decrement pertaining to disposition of the North 40 and 177/178 parcels was improper. The amount claimed was LMC's estimate of the difference between what it contends should have been allocated to its flexibly priced contracts and what the government maintained was properly allocable with respect to the sales. However, the claim also detailed facts surrounding, and sought resolution of the parties' dispute concerning all six of the sales. (Tr. 3/231-32; R4, tab 53)

49. The DACO issued a final decision denying the claim on 13 March 2003 (R4, tab 58). The DACO treated the claim as a request for contract interpretation regarding appellant's accounting treatment for the sales of all subject properties. He determined that LMC's accounting treatment "does not result in an equitable or reasonable outcome." (*Id.* at 8) The DACO indicated that there were several potential valuation methods of apportioning the proceeds of sale as between the land and buildings for consideration including: the NBV of the buildings; tax assessed value; and real estate appraisals. The final decision expressed a preference for using appraisals (*id.* at 4-7). The DACO believed "there is a high probability that a potential buyer existed who would have utilized the existing buildings" (*id.* at 10). At the hearing, the DACO stated that he had "a lot more concerns" about the use of appraisals and therefore considered that use of the NBV method was the most appropriate method to apportion the sales proceeds, resulting in a "zero loss-zero gain" for the buildings (tr. 3/237-38).

50. LMC timely appealed the final decision on 17 April 2003 (R4, tab 59).

H. <u>Expert Testimony</u>

51. The parties have introduced extensive expert real estate appraisal evidence (R4, tabs 38, 63, 192, 321). For reasons stated in the decision portion of this appeal, it is not necessary to make detailed findings concerning these appraisals. The Board has carefully reviewed the appraisals along with associated testimony and the parties' arguments. Based on that review, we have concluded that Mr. Hulberg's expert appraisal is the most persuasive appraisal evidence of the respective values of the land and buildings on the sold parcels. The Hulberg appraisal employed three standard valuation methods— the cost approach; sales comparison approach; and income approach. Using

each of these of these approaches, the value of the buildings on the six parcels sold was zero, confirming in Mr. Hulberg's opinion the zero value placed on the buildings by the buyers as evidenced by the sales transactions and surrounding circumstances. The total amount paid for the parcels was paid for the land, and the value of the subject properties for redevelopment was greater than the value of the land with continued use of the existing buildings according to Mr. Hulberg. (Tr. 2/187-240; R4, tab 63, app. supp. R4, tab 192)

52. The parties introduced the testimony of three expert accounting witnesses, each of whom submitted an expert report. Appellant's experts were Dr. James Bedingfield and Mr. Patrick A. McGeehin. The Government's expert was Professor Stanley Siegel. (R4, tabs 61, 62, 320)

53. Dr. James Bedingfield was proffered and received by the Board and testified for appellant as an expert in accounting. Dr. Bedingfield holds a doctorate in accounting from the University of Maryland. He served on the faculty at the University of Maryland from September 1967 until his retirement in June 2005, and as Chairman of the Accounting Department from January 1996 until June 2005. Dr. Bedingfield is a C.P.A. and has served two four-year terms as a member of the Cost Accounting Standards Board, from 1996 to 2004. He co-authored a book on government contract accounting entitled Government Contract Accounting, which has been published in two editions. Dr. Bedingfield is also a member of several professional associations, including the American Institute of Certified Public Accountants ("AICPA"), the Maryland Association of Certified Public Accountants, the Association of Government Accountants, and the American Accounting Association. (Tr. 3/79-84; R4, tab 61)

54. Dr. Bedingfield expressed his opinion on the propriety of LMC's accounting treatment for these six sales transactions. He concluded that LMC appropriately accounted for these transactions. (Tr. 3/85; R4, tab 61)

55. Detailed reasons for his conclusion are set forth in his expert report at paragraphs 18 through 23:

> 18. What FAR 31.205-16 and CAS 409.50(j) do not do is to instruct us as to how gains/losses are to be computed when land and buildings are sold together. The significance of this is that the gain/loss on the sale of the land (i.e., ". . . arising from the sale or exchange of capital assets other than depreciable property. . . ." under FAR 31.205-16(f) is to be excluded in computing contract costs whereas the gain/loss on the sale of the buildings (i.e., depreciable property

addressed in FAR 31.205-16(b)) is to be included in computing contract costs.

19. Where (a) there is the need to determine the gain/loss on the individual components (i.e., land vs. buildings) and (b) there is evidence that the land and building contribute to the overall proceeds received (e.g., where the land and buildings are intended to continue being used after the sale), an allocation must be made to determine the individual component's gains and losses. Such an allocation can be accomplished on a number of bases. For example, I have previously addressed this issue in the abstract in my book:

> For example, in a mass disposition, the amount paid for individual assets (which are at various stages of their depreciable lives) is often not specified. The entire "Market basket" of assets – such as an entire plant facility – is disposed of at one price. Thus, the determination of the gain or loss on individual assets is complicated, and usually accomplished by allocating the sales proceeds on some basis such as the undepreciated cost of the individual assets. (Government Contract Accounting, Bedingfield and Rosen, p. 9-49)

20. A look at the general accounting literature shows that such allocations are approached from the standpoint of the purchaser (which should be a mirror image of that of the seller) and we find:

> A special problem of pricing fixed assets arises when a group of plant assets is purchased at a single lump-sum price. Such a situation is not at all unusual. When it occurs, the practice is to allocate the total cost among the various assets on the basis of their relative fair market values. The assumption is that costs vary in direct proportion to sales value. This is the same principle that is applied to allocate a lump-sum cost among different inventory items.

> To determine fair market value, any of the following might be used: an appraisal for insurance purposes, the assessed valuation for property taxes, or simply an independent appraisal by an engineer or other appraiser. (Intermediate Accounting, Kieso, Weygandt & Warfield, pp. 480-481).

21. We find similar approaches in the area of income tax accounting (e.g., IRC Section 1.1060-1 dealing with allocation of proceeds by both sellers and purchasers for a group of assets that are sold/purchased).

22. The theory behind these approaches is premised on all of the components of the assets sold having some positive contribution to the overall sales price, and the use of some proxy for that contribution (e.g., allocation to individual assets based on assessed value, book value, estimated market value, etc.) providing a reasonable basis to apportion that overall sales price.

23. When this premise is unfounded (e.g., where there is evidence that a component of the assets sold did not make a positive contribution to the overall sales price) there is no basis to allocate any portion of the sales proceeds to that component. For example, the Internal Revenue Code at Sec. 1.165-3 deals directly with what we have in this case: the sale of land and building where the intent is to demolish the buildings:

> (a) Intent to demolish formed at time of purchase. (1) Except as provided in subparagraph (2) of this paragraph, the following rule shall apply when, in the course of a trade or business or in a transaction entered into for profit, real property is purchased with the intention of demolishing either immediately or subsequently the buildings situated thereon: No deduction shall be allowed under section 165(a) on account of the demolition of the old buildings even though any demolition originally planned is subsequently deferred or abandoned.

> The entire basis of the property so purchased shall, notwithstanding the provisions of Sec.1.167(a)-5, be allocated to the land only. Such basis shall be increased by the net cost of demolition or decreased by the net proceeds from demolition.
>
> * * *
>
> (2)(i) If the property is purchased with the intention of demolishing the buildings and the buildings are used in a trade or business or held for the production of income before their demolition, a portion of the basis of the property may be allocated to such buildings and depreciated over the period during which they are so used or held. . . . In any event, the portion of the purchase price which may be allocated to the buildings shall not exceed the present value of the right to receive rentals from the buildings over the period of their intended use. . . .

With regard to the permissive provision quoted above at paragraph (a)(2)(i), which is directed to the purchaser, it is my understanding that the purchaser of Parcel 8 intended at the time of the sale, and still intends, to demolish the existing buildings and to construct new buildings and that the purchaser's development plan for the site which was approved by the City of Sunnyvale presumes the demolition of the existing buildings. The rental rates of $1.00 sq. ft. and $.25 sq. ft. for the one year lease back of the Parcel 8 buildings, entered into at the time of the sale, indicate that the lease was not entered into by the purchaser primarily for use in its trade or business or for the production of income as referenced in this subparagraph.

(R4, tab 61 at 2925 – 28)

56. It was Dr. Bedingfield's opinion that from the buyer's perspective under Generally Accepted Accounting Principles (GAAP), where the facts of the transaction indicate that only the land portion of the transaction drove the proceeds, all of the proceeds are assigned to the land, and the same approach should be used with regard to the seller's accounting. Dr. Bedingfield reasoned that allocation itself is a "fallback

position:" "[w]here we know what drove the transaction, we directly assign" and "[w]here we are in doubt about it, that's when we end up with an allocation." Dr. Bedingfield opined, based upon his examination of the documents (including the sales agreements) in this case, that, "we have the evidence that the direct assignment is deterministic here, and should be used as opposed to any other method." He concluded that, in these transactions, there was evidence that the parties had made direct assignment of the sale proceeds entirely to the land and that an allocation was not required. (Tr. 3/91-94)

57. Dr. Bedingfield disagreed with the report prepared by the Government's expert, Professor Siegel (*infra*), who concluded that the buildings had to be assigned some value "in lieu" of an agreement between the parties. Dr. Bedingfield based his disagreement upon the fact that Professor Siegel had overlooked a "line of sight agreement" that was "reached by the parties . . . in terms of how the proceeds should be assigned" and that he had ignored the reality that the parties' "fingerprints [were] all over these transactions, indicating that it was the land driving the value, or land driving the transaction, not the buildings." Dr. Bedingfield explained that, while he did not believe there to be a standard form for assigning the proceeds in such instances, if the parties had been presented with such a form to satisfy the requirement "they would have filled it out [so] that all proceeds would have been assigned to the land and not to the buildings." (Tr. 3/96-98)

58. Mr. Patrick McGeehin is a licensed C.P.A. and holds a B.S. in accounting from the University of Scranton and an M.B.A. in government contracting from George Washington University (tr. 3/133, 135). He was founding shareholder of the accounting firm of Rubino & McGeehin, which employs in excess of 60 accounting professionals (tr. 3/133, 134). Mr. McGeehin has testified as an expert witness for both the government and contractors about 100 times before a variety of forums, including this Board, the Court of Federal Claims and numerous other federal and state courts and boards. Mr. McGeehin is a member of several professional organizations, including the AICPA and the Maryland Association of Certified Public Accountants. (R4, tab 62; tr. 3/133-35)

59. Mr. McGeehin concluded in his report that LMC properly treated the proceeds of each of the sales as entirely allocable to the land:

> The task required in this situation is to reflect on the Company's books and records the financial results of each of the sales transactions that, in fact, took place. The accounting requirement is to reflect the substance of those transactions (i.e., what did the seller receive; what did the buyer give to the seller; and for what did the buyer pay whatever

> consideration he or she paid). Thus, the appropriate accounting question is not whether the buildings had value, but is whether, under the circumstances of these sales, any portion of the net amount realized (i.e., the sales proceeds paid by the buyer and received by LMC), should be allocated to the buildings instead of all of the proceeds being allocated to the land as accounted for by LMC.
>
> In my opinion, the answer to that question is no. In the first instance, allocations of the sales proceeds between the assets disposed of in the sale transactions were required by both CAS 409.50(j)(1) and FAR 31.205-16(b). Secondly, under the circumstances of the Sunnyvale property sales, where the documentation establishes that the buyers were purchasing the land for redevelopment and were not acquiring the buildings as a revenue producing asset in its business, LMC's allocation of all of the sales proceeds to land was proper and in accordance with sound accounting principles and practices.

(R4, tabs 62 at 3110-11)

60. Mr. McGeehin's report stated, "When the FAR and CAS do not specifically address an accounting issue [as in this case], it is proper to then look to other authoritative sources, specifically GAAP and, in appropriate circumstances, the IRS Code and Regulations for guidance" (R4, tab 62 at 3115). With respect to GAAP, Mr. McGeehin's report stated:

> 3. <u>*Accounting is intended to reflect actual transactions*</u>. A fundamental concept of financial accounting is that entries are made on a company's books and records to reflect *transactions* that have actually occurred. Stated another way, for financial reporting, the objective of the financial statements is to reflect what actually happened, as opposed to theoretical possibilities of what might have happened, or pro-forma results or projections. This principle is confirmed [by] the Financial Accounting Standards Boards (the Board) in Statement of Financial Accounting Concepts (FAC) No. 5. FACs are a series of publications issued by the Board to state the conceptual framework for financial accounting and reporting. The FACs set forth objectives and fundamentals that are the basis for development of financial accounting and

reporting standards. FAC 5 states that "The fundamentals are the underlying concepts of financial accounting – concepts that guide the selection of *transactions, events, and circumstances* to be accounted for."

In FAC 5, at paragraph 5, the FASB states that:

> "Items that are recognized in financial statements are financial representations of certain resources (assets) of an entity, claims to those resources (liabilities and owners' equity), and *the effects of transactions* and other events and circumstances that result in changes in those resources and claims."

Therefore accounting must reflect the transaction that actually occurred. As reflected in the discussion above, a basic tenet of GAAP is to reflect, in a company's books and records, the results of the *actual transactions* that have taken place between the company and other entities (e.g., customers, vendors, etc.). Except for related party situations, where there may be a lack of an arms-length relationship, GAAP does not reflect adjustments for events that might have occurred if different entities had been party to the transaction. In the immediate situation, LMC, as the owner of the property, is entitled (and actually required as part of its obligations to its shareholders) to enter into sales *transactions* that are in its best interest, and which bring the company the best economic arrangement. Having done so, the objective of GAAP is to *record what the transaction was* between buyer and seller, based on the details of the arrangement. In this case, the details of the arrangement show that the buyers were purchasing the land only, since they were intending to demolish the buildings. This intent is reflected in the purchase and sale agreements, which included references to the fact that the new buyer was intending to demolish the buildings, despite the fact that this arrangement may have had some negative tax and economic repercussions to the buyers in terms of their being unable to write off a portion of the purchase amount (i.e., any amount that they might have tried to assign to the buildings) for tax purposes, as discussed further in 5, below. It also is confirmed by what the purchasers actually did with the property, which, with the exception of Parcel 8, was to demolish the existing structures and construct new office buildings on the land. And, I am not aware of any dispute regarding the fact that the buyer of Parcel 8 also intended to demolish the buildings shortly after the sale and construct new buildings on that site.

As such, to be true to the basic concept in GAAP of recording *what the transaction actually was,* as discussed above, requires that the *details of the transaction drive the accounting,* and not some theoretical notion of what someone else might have paid for the buildings if they were being used for another purpose or what an appraiser might have shown the value of the buildings to be prior to the sale. The fact was that LMC sold the properties, and once that action was taken, it was necessary for GAAP purposes to reflect *what the transaction actually was,* based on all the facts known at the time of the sale, including the purchase and sales contract provisions at issue. As such, reflecting the transaction as being comprised of proceeds paid for land alone is in accordance with the basis tenets of GAAP.

4. *Using buyer's intent to allocate purchase proceeds is consistent with GAAP.* Although there is no specific GAAP guidance as to how a seller should allocate purchase proceeds between land and buildings as part of a single sales transaction (since the breakout of the gain attributable to the land as opposed to that for the buildings is not significant in terms of the reporting of financial results for the seller), the treatment under GAAP for the buyer of property that it intends to demolish is covered, and is of relevance. Similar to the tax provisions discussed below, when a company purchases land and buildings that it intends to demolish as part of a development project, the buildings are reflected as part of the land costs, and no depreciation may be taken on any amounts that might be associated with the buildings, since they have never been placed in service. (See, for example, *Fundamental Accounting Principles*, William W. Pyle, Kermit D. Larson, Ninth Edition, p. 341). This text is consistent with the Proposed Statement of Position "Accounting for Certain Costs and Activities Related to Property, Plant and Equipment," issued by the Accounting

Standards Executive committee of the American Institute of Certified Public Accountants which provides, in Paragraph 25 of Appendix A, Basis for Conclusions, ". . . demolition costs should be capitalized as a cost of the real estate when the demolition is contemplated as part of the acquisition of real estate and occurs within a reasonable period of time thereafter. Under those circumstances, it is clear that the cost of the real estate includes both the purchase price and the costs the buyer is willing to pay to demolish the real estate to prepare it for its intended use." By inference, since the intended use of the asset is the construction of a new building, the entire purchase price is allocable to the cost of the land, since the existing structures not only had no use to the buyer, they were, in fact, a liability. As such, this GAAP treatment, which is applicable to the purchase side of the transaction, should mirror the seller's treatment of the transaction and supports LMC's position in this case.

GAAP also provides guidance on the measurement of fair value for "Long Lived Assets," including those assets to be disposed of by sale, or assets that have been impaired. This guidance is found in the Financial Accounting Standard Board (FASB), Statement of Financial Accounting Standards (FAS) 144 ["Accounting for Impairment or Disposal of Long-Lived Assets," FASB August 2001, ¶ 22, 23, B39]. FAS 144 was issued in 2001, and superseded FAS 121, which had been issued in 1995. The relevant provisions relating to measurement of fair value are identifical in FAS 121 and FAS 144. These FAS provisions state that "The accounting model for long-lived assets to be disposed of by sale is used for all long-lived assets, whether previously held and used or newly acquired. That accounting model retains the requirement of Statement 121 to measure a long lived asset classified as held for sale at the lower of its carrying amount of <u>fair value</u> less cost to sell and to cease depreciation (amortization). This approach has also been repeated under Paragraph 34 of the same rule.

"<u>Fair Value</u>" of an asset is described under Paragraph 22 of FAS 144 as "the amount at which that asset (liability) could be bought (incurred) or sold (settled) in a current transaction between willing parties, that is, other than a forced

> or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available."
>
> As the FAS indicates, the determination of fair value does not look to appraisals as the best evidence of fair market value if quoted market prices in active markets are available. LMC's approach of recording what the sales agreements provide for, incorporating the buyer's intent to demolish the buildings, reflects LMC's use of buyer's intent and is equivalent to using firm market quotes (the contracts between arms length buyers and sellers), and is consistent with GAAP.

(R4, tab 62 at 3116-21)(footnotes omitted; emphasis in original)

61. Mr. McGeehin also emphasized in his report that LMC's accounting treatment was consistent with "analogous, IRS Code Sections" (R4, tab 62 at 3121), stating:

> IRS Code Section 280B prohibits the taxpayer, in a situation where real property is purchased with the intention of demolishing the structures located on the land, from taking a deduction on account of the demolition of the buildings. The entire basis of the property purchased must be allocated to the land only. The basis shall be increased by the net cost of demolition or decreased by the net proceeds from demolition.
>
> The treatment by LMC of allocating the entire proceeds of the sale to land when the buildings were to be destroyed is consistent with this IRS regulatory requirement on the buyer, as it represents the mirror of the transaction from the seller's side.

(R4, tab 62 at 3121-22)(footnotes omitted; emphasis in original)

62. Mr. McGeehin's report also stressed that appellant's accounting treatment was consistent and "symmetrical" with the accounting treatment accorded the sales by the purchasers of the parcels and that the sales were consistent with prior audit cost saving recommendations to dispose of excess facilities (*id.* at 3122-3126). Mr. McGeehin also prepared a supplemental expert report that estimated the cost savings accruing to the government from disposition of the facilities, including reduced property taxes, repair and maintenance, insurance, utilities, and facilities capital cost of money. He approximated that the government's share of these operating costs avoided by disposition

of the subject properties over the weighted average remaining useful lives of the buildings would be at least $119 million when reduced to net present value, *i.e.*, substantially more than the government's share of the total $80,020,075 loss resulting from the sales. (Tr. 3/155-58; app. supp. R4, tab 65)

63. Mr. McGeehin considered that the "FAR and CAS provisions on mass or extraordinary disposal provide for negotiation of the period [costs] over which the gain/loss will be allocated; they do not provide that the amount of the cost is subject to negotiation" (R4, tab 62 at 3126-27). He also opined that the fact that some buildings were leased back to LMC does not warrant assigning some accounting "value" to those buildings where the intent of the parties to demolish the properties and terms of the sale regarding redevelopment are clear (*id.* at 3127-29).

64. Professor Stanley Siegel has been a Professor of Law at New York University (NYU) Law School since 1986. He received a Bachelor of Science degree, *summa cum laude*, from NYU and his Juris Doctor degree, *magna cum laude*, from Harvard Law School. Among his extensive accomplishments, he has been a Professor of Law at the University of Michigan Law School from 1966 to 1974 and the UCLA Law School from 1976 to 1986, as well as NYU. He is a Certified Public Accountant and has taught accounting, finance, business associations and other courses in the areas of taxation and business throughout his career and authored or co-authored textbooks on business associations and accounting. He is a member of the American Bar Association and is admitted to practice as an attorney in New York, California and the District of Columbia. (Supp. R4, tab 320) The government offered and the Board received Professor Siegel as an expert on GAAP and federal taxation (tr. 5/17-18).

65. Professor Siegel considered that the accounting treatment associated with the subject property sales "must be fair and equitable on a case by case basis" (supp. R4, tab 320 at 7). In reaching this conclusion, he relied on the companion provisions of FAR 31.205-16(e) and CAS 409.50(j)(3) dealing with "mass or extraordinary sales" (*id.*). In Professor Siegel's opinion a "fair value" must be assigned to the buildings because they had "value" to LMC. He considered that there were several ways to approximate the "value" of the buildings at the time of sale, including appraisals and tax valuations, but in his opinion the best measure in this case was the NBV of the buildings and that some of the proceeds of the sales should be allocated to the buildings based on their NBV. (Tr. 5/23, 49-50, 55; i*d.* at 17)

66. Quoting *Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements (1985)* (FAC 6), Professor Siegel considered that the sales here were analogous to "apportioning the cost of a 'basket purchase' to the individual assets acquired on the basis of their market value" (supp. R4, tab 320 at 8-9, 16).

67. Professor Siegel opined in his report that there is no requirement that the sellers' accounting for the transactions symmetrically match the purchasers' allocations of the proceeds between land and buildings (supp. R4, tab 320 at 10).

68. In Professor Siegel's opinion, the buildings were not "impaired" and LMC did not and would not, prior to their sale, have been permitted to write them down as impaired under criteria set forth in FASB *Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived of Assets (2001)* (FAS 144) or the earlier FASB, *Statement of Financial Accounting Standards No. 121 (1995)* (FAS 121) which was replaced and restated by FAS 144 (supp. R4, tab 320 at 12-13).

69. Professor Siegel did not consider that the "fair value" of the land and buildings could be determined from the sales documents (supp. R4, tab 320 at 3, 17). He noted in his report that, "The terms of the sales did not allocate the sales price between the land and buildings, and therefore the sales terms provide no support for the allocation of the entire proceeds to the land. In the absence of an arm's length good faith allocation of the sales price, applicable GAAP requires appropriate allocation of the sales price in a bulk sale of assets in proportion to the book values of those assets, or their fair values, or—if applicable— in proportion to readily available market values of those assets" (*id.* at 3). Professor Siegel considered that the buyers' intention "to demolish the buildings does not alter their fair market value" (*id.* at 18). Professor Siegel did not consider that the sales agreements were "arm's length transactions" sufficient to provide a basis to allocate the proceeds among the land and buildings because there was no express provision on allocation. He opined that even if an allocation was made that apportioned all proceeds to the land, it would not have been in "good faith." However, he conceded that he had seen specific allocation of the proceeds in only one prior instance in his experience involving a business acquisition and did not detail why he considered any of the transactions to be other than the result of arms length bargaining. (Tr. 5/22-23, 31-34, 58-59).

70. Professor Siegel also opined in his report that, "there is no authority in FAR, CAS or the GAAP hierarchy for the application of tax accounting principles to the determination of a cost or accounting question for non-tax purposes" (supp. R4, tab 320 at 10).

DECISION

This primary issue in this appeal involves measuring appellant's allowable loss on sales of buildings on six parcels of appellant's land in Sunnyvale, California during the period 1998 to 2001.[3] As prescribed at both FAR 31.205-16(b) and CAS 409.50(j)(1), the gain or loss on the disposition of an asset is the difference between the "net amount realized" (or NAR) and the undepreciated balance or net book value of the asset sold. In this case, the undepreciated balances of the buildings have been stipulated by the parties. The "net proceeds from sale" for the sold parcels as a whole also has been stipulated. The sole issue is what was the "net amount realized" by appellant for the buildings as distinct from the land, a nondepreciable asset for which no gain or loss is computed in determining costs under FAR 31.205-16(f).

Appellant argues that the "amount" paid for the buildings is apparent from the sales agreements and surrounding circumstances. Appellant contends that the purchasers of the parcels paid nothing for the buildings. It notes that all buyers or potential buyers intended to demolish the buildings and redevelop the land to accommodate the needs of burgeoning high technology businesses in Silicon Valley during the period over which the sales occurred. LMC emphasizes that its existing buildings on all but one of the parcels were actually demolished shortly before or after their sale. The sole reason that Parcel 8 buildings were not demolished was the sharp downturn experienced by the dot-com industry at approximately the time of the sale of that final parcel. According to appellant, the reality of the transactions should drive the apportionment decision and the entire NAR should be allocated to the land.

The government maintains that the buildings had "value" to LMC and some of the sales proceeds should be apportioned to the buildings. The government has at various times proposed that apportionment should be accomplished either by appraisal of the buildings prior to their sale or by using their NBV at the time of the sales. It also points to pre-sales insurance and tax valuations as further evidence that some value should be attributed to the buildings. Alternatively, the government suggests that the Board remand the issue of valuation for further negotiation pursuant to the mass or extraordinary disposition provisions of the FAR and CAS.

[3] The claim in this appeal arose from the decrement taken by the DACO with respect to two of the sales. However, it also requested resolution of the parties' disputes concerning the allowable loss resulting from the sale of all six parcels. The contracting officer's decision treated appellant's claim as a request for an interpretation of the pertinent regulations governing the issue for all six of the subject property sales. It is well settled that we have jurisdiction to adjudicate claims under the Disputes clause seeking "interpretation of contract terms, or other relief arising under or related to the contract." *E.g. TRW, Inc.,* ASBCA No. 51172, 51530, 99-2 BCA ¶ 30,407 at 150,331; *Martin Marietta Corp.,* ASBCA No. 38920, 90-1 BCA ¶ 22,418 at 112,609.

We are in substantial agreement with positions advocated by appellant in this appeal. The fundamental incontrovertible fact in this case is that the buyers of all of the six parcels paid nothing for the buildings on the land; the entire amount paid (or cash) was for the land. Therefore, we consider that to the extent that the consideration received by LMC for the sale consisted solely of cash, appellant properly treated the entire net book values of the buildings as losses.

However, there are potentially significant distinctions between the sales of the two parcels (parcels 177/178 and 8) containing buildings that were leased back to LMC and the four parcels where all buildings were demolished shortly before or after the sale and not leased back to appellant. In the latter case, we conclude that appellant received nothing more than the "net proceeds of sale" (or cash) for the parcels and that LMC properly treated the entire NBV of the demolished buildings as a loss. In the case of the two parcels with buildings that were leased to LMC after the sales, however, we conclude that appellant may have received consideration associated with its leasehold interests in the buildings in addition to the cash received. Because of uncertainties in quantifying any additional consideration associated with the leases, we consider it appropriate to remand the matter to the parties for further negotiations solely on that narrow quantum issue. In either case, there is no need to resort to possible alternative methods to "value" the buildings and/or apportion the cash proceeds as between the land and the buildings.

We further conclude that the mass/extraordinary disposition provisions of CAS 409.50(j)(3) and FAR 31.205-16(e) do not supersede the formula for determining the "net amount realized" prescribed in both CAS 409.50(j)(1) and FAR 31.205-16(b). Moreover, even if the transactions are viewed as mass or extraordinary dispositions, we consider that the best measurement of the losses is that produced by application of the measurement formula of CAS 409.50(j)(1) and FAR 31.205-16(b) as corroborated by the most persuasive appraisal evidence in the record. Our detailed reasons for these conclusions follow.

I. The CAS/FAR Measurement Formula and Determination of Net Amount Realized

A. The Cash Only Parcels

The basic first step in determining the "net amount realized" for the buildings is to examine the express details of the sales agreements and the surrounding circumstances of the transaction. If the amount paid by a fair market buyer in an arm's length, good faith transaction is apparent from the sales agreement and surrounding circumstances, that amount should generally be used, assuming no additional consideration is received by the seller. In this case, there is no uncertainty regarding the amount paid for the buildings and no persuasive evidence that resort to an alternative "valuation" method is required to allocate the cash received among the land and the buildings.

Although the sales agreements do not expressly "allocate" the cash paid to the land and the buildings, their terms and conditions indicate that the entire amount paid was for the land and the NAR for the buildings was zero. The agreements incorporated specific provisions reflecting the buyer's intent to demolish the buildings and redevelop the land (finding 22). They contained provisions addressing the parties' liability risks and insurance obligations related to the condition of the parcels and demolition. The government's contentions ignore the essence of the agreements.

The sales were good faith, arm's length transactions. There is no evidence that the sale of any parcel was an unreasonable business decision by LMC. There is no proof that in fact some amount was paid for the buildings. There is no evidence that any potential buyer at any time during the period over which these sales transactions occurred expressed any interest in retaining, using or leasing any of the existing buildings, except for LMC's temporary leasing of buildings on parcels 8 and 177/178 pending demolition and redevelopment of the land. Nor is there evidence that LMC received offers to lease buildings on any parcel.

In addition, the post-sale conduct of the parties supports our conclusion that no "amount" was received for the buildings. That conduct corroborates the intent expressed in the sales agreements to demolish the buildings and redevelop the land. The buyers in effect "paid" to dispose of the buildings, or LMC itself incurred additional pre-sale costs to demolish them. The buildings were demolished on four of the six parcels after the sale by the purchaser/redeveloper or immediately before the sale by LMC preparatory to sale pursuant to the pertinent sales agreement. The buyers of those parcels then proceeded to construct modern, multi-story, glass and steel, Class A office buildings as planned.

The sales also reflected well-known trends in the contemporaneous real estate development community before and after the sales. To Silicon Valley real estate developers, LMC's buildings were outdated, Class C facilities. In this regard, the most persuasive appraisal or "valuation" evidence in the record (the Hulberg appraisal) further reinforces the fact that no amount was received for the buildings. Mr. Hulberg concluded that the total amount paid for the parcels was paid for the land and the value of the subject properties for redevelopment was greater than the value of the land with continued use of the existing buildings. We also note that no material "value" was placed on the buildings by the county tax assessors.

B. <u>The Cash and Lease Parcels (177/178 and 8)</u>

The government maintains that the leasing of buildings, most significantly on the sixth and final sales parcel, indicates that the buildings had "value" to LMC that should be considered in allocating the sales proceeds as between the land and the buildings. We disagree. We consider that the lease back transactions do not affect the propriety of the allocation of the cash amount received by LMC. As discussed in detail herein, resort to valuation methods is unnecessary in this case because the cash received by the seller was clearly for the land and not the buildings on any of the six parcels. The temporary lease backs of buildings on parcels 8 and 177/178 do not alter that fact with respect to those two parcels and do not warrant an apportionment to the buildings of the net cash proceeds, received by LMC.

Nevertheless, the surrounding facts and nature of the leases indicate that appellant may have received additional non-cash consideration that materially increased the "net amount realized" by appellant for the parcels. On the one hand, the leases were conveniences to both parties pending redevelopment and accommodated LMC's desire for an orderly transition and relocation of its employees during the period the buyer was seeking requisite zoning and redevelopment approval. Because of the anticipated length of that approval process there was no need for the buildings to be vacated immediately.

However, appellant may have paid "nominal" below market rental rates to the buyers of the parcels. The extent if any, that the rents paid (plus LMC's incurrence of operating, maintenance, utility and other lease-related costs) were below the fair rental value of the buildings, is not determinable on this record. Nor is there evidence concerning possible accounting treatments of any added consideration that may have been realized by appellant in connection with these lease arrangements, including the factors and assumptions that might be used in any present value computation of the difference over the lease term of the fair rental value less the amount paid by LMC. Accordingly we remand the quantification of any additional consideration that may have been received. To the extent that additional consideration may have been received, that amount should defray the losses taken by LMC with respect to these sales.[4]

In determining the amount of additional consideration, if any, that LMC may have received as a result of the lease back arrangements, we note that FAR 31.205-16(a) and CAS 409.50(j)(1) require the assignment of gains/losses to the accounting period in which the disposition occurs. This necessarily entails a determination of the amount of the gain/loss in that period essentially contemporaneous with the sale. Unforeseen post transaction events during later accounting periods are not a reason to second guess the accuracy of the contemporaneously required cost measurement and assignment. The determination of any gain or loss should therefore be based on relevant foreseeable facts and circumstances.

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[4] We express no opinion regarding the accounting treatment (including amortization) in the year of sale or subsequent accounting periods of any additional assets (consideration) realized by appellant as a result of leasehold interests.

C. “Value” Measurements

The government maintains that the net amount realized in this case should be measured by the pre-sale “value” of the land and buildings to LMC. The primary evidentiary bases for the government’s contention that the buildings had value are appraisals designed to estimate the presale value of the buildings, Professor Siegel’s testimony regarding the contribution of the buildings to LMC’s pre-sale performance, the pre-sale valuations of state taxing authorities and the fact that the buildings had substantial undepreciated book values prior to the sale. The government also argues that the lease back arrangements on parcels 177/178 and 8 indicate that the buildings had “value.” The valuation and treatment of possible additional non cash consideration that may have been received by LMC with respect to its leasehold interests are addressed above. We have concluded that any additional consideration related to the leases does not affect how the cash proceeds should be apportioned. The following discussion addresses whether “value” measurements generally should be used to apportion the cash proceeds received by LMC in the circumstances of this case.

Because we consider that the NAR for the buildings is readily determinable from the transactions themselves and surrounding circumstances to the extent of the cash received, it is unnecessary to make detailed findings regarding alternative “valuation” methods proposed by the government to apportion the cash proceeds of sale.

FAR 31.205-16(b) and CAS 409.50(j)(1) are concerned with determining the net amount realized for each depreciable asset sold. The term “value” does not appear in the formula for measuring the gain or loss on disposition of an asset. Instead, the key term is “amount.” To the extent “value” may be relevant, it is a buyer-driven, “fair market” valuation that governs where it is clearly and readily determinable as in this case. That valuation is generally reflected in what was actually paid for the asset, *i.e.*, the “amount” realized by LMC. Where, as here, the economic substance of the sale transaction is objectively discernible, we consider that the measurement inherent in the actual market price or “amount” paid in an arm’s length transaction is required by the regulations without consideration of more imprecise and subjective estimates of “value” to the seller.

The government essentially contends that GAAP requires consideration or application of valuation and estimating methods that would supplant the plain language and meaning of FAR 31.205-16(b) and CAS 409.50(j)(1). This argument lacks merit for two reasons. First, the precise FAR/CAS measurement formula controls measurement of gain or loss on asset disposition. Its application to the facts of this case is clear. There is no persuasive evidence that any amount was paid for the buildings. GAAP does not supersede the results required by the regulatory formula. Second, we do not construe GAAP to be inconsistent with those results. As discussed below, the government’s contentions ignore fundamental GAAP concepts and attempt to apply peripheral FASB statements that are designed for special situations not relevant to the straightforward sales transactions in this case.

Fundamentally, GAAP requires that the accounting for the transactions reflect their economic substance. As emphasized by Dr. Bedingfield and Mr. McGeehin, LMC's accounting treatment complied with GAAP because that treatment reflected the economic reality of the sales transactions. LMC's accounting treatment is consistent and comports with "what actually happened." The transactions here were not complicated. The cash amount received by LMC was for the land alone and, accordingly, LMC directly apportioned the sales proceeds to the land. Resort to possible alternative allocation or estimating methodologies was not required. FAC 6 cited by Professor Siegel also supports the principle that the purchase price of a "basket" of assets be apportioned based on their "market values." The respective "market values" of the land and buildings on the six parcels were readily determinable and established pursuant to actual market transactions.

The government's reliance on certain statements of the Financial Accounting Standards Board (and its predecessor) is misplaced. FAS 121 and FAS 144 pertain to valuations of impaired assets for financial accounting purposes. Their relevance to the issues in this case is peripheral at best. FAR 31.205-16(g) does not permit impairment write downs. Therefore, methods for measuring impairment losses in FAS 121 and FAS 144 have only marginal relevance in government contract accounting. In addition, they do not address valuation of sold assets. The value of sold assets is determined by the market price paid for them.

<u>II. Mass/Extraordinary Disposition Treatment and Equitable Considerations</u>

The government argues that the sales should be treated as mass or extraordinary dispositions pursuant to FAR 31.205-16(e) and CAS 409.50(j)(3) and the parties should be required to negotiate what the government considers to be an "equitable" result pursuant to those provisions. In essence, the government seeks to employ methods of determining the buildings' "value" under FAR 31.205-16(e) and CAS 409.50(j)(3) that we rejected in our analysis of the application of the measurement formula of FAR 31.205-16(b) and CAS 409.50(j)(1). The government's arguments are based on four assumptions: 1. The transactions collectively (or an undefined subset thereof) are mass or extraordinary dispositions under either FAR 31.205-16(e) or CAS 409.50(j)(3); 2. FAR 31.205-16(e) requires that mass or extraordinary dispositions are to be "considered on a case-by-case basis;" 3. The measurement of gains and losses must also be performed "on a case-by-case basis" pursuant to FAR 31.205-16(e) as an implied exception to the express measurement formula prescribed in FAR 31.205-16(b); and 4. Measurement of gains or losses under FAR 31.205-16(e) requires use of "equitable" valuation methodologies. The government concludes that the case should be remanded to the parties for negotiations using appraisals, net book values or another "equitable" procedure that will apportion some of the sales proceeds to the buildings.

All of the government's premises as well as its conclusion are highly problematic. However, we need not address each of them. We assume, *arguendo,* that the sales of the six parcels were mass or extraordinary sales. The key premise of the government's argument is that gains or losses are required to be *measured* under FAR 31.205-16(e) as an implied exception to FAR 31.205-16(b). We reject that essential premise for the reasons stated below.

First, the government's interpretation creates conflicts between the CAS and FAR. CAS 409.50(j)(3) uses the term "may." It is not mandatory but merely affords the parties the option of voluntarily reaching agreement on various accounting issues that may arise in the case of mass or extraordinary dispositions. In contrast, CAS 409.50(j)(1) mandates that its measurement formula "shall" be used. The government's construction of FAR 31.205-16(e) to require an alternative measurement technique negates the CAS requirement to measure the gains in accordance with the CAS 409.50(j)(1) formula.

Moreover, CAS 409.50(j)(1) contains no exception to use of the formula in the case of mass or extraordinary dispositions. However, it does contain an exception with respect to assigning losses to accounting periods. Immediately before the measurement formula, it states that gains and losses "shall be assigned to the cost accounting period in which disposition occurs *except as provided in*" [subparagraph (j)(3)] (italics added). Thus, there is a stated exception for the assignment of losses but not for calculating or measuring the amount to be assigned. In addition, CAS 409.50(j)(1) includes a limitation on application of the measurement formula in the case of gains, but no such exception is stated with respect to losses. We decline to add implied exceptions or limitations on application of the formula to those expressly specified in the CAS.

In addition, the government's interpretation fails to harmonize the provisions of FAR 31.205-16(e) and FAR 31.205-16(b). FAR 31.205-16(b), like the corresponding CAS 409.50(j)(1), states that it measurement formula "shall" be used in determining gains or losses. The FAR provision, like CAS 409, does not provide for exceptions or the use of possible alternative methodologies in measuring losses. In contrast, the FAR (as well as the CAS) expressly provides for certain exceptions with respect to gains.

In the overall context of FAR 31.205-16 (as well as CAS 409.50(j)) and reading the clauses of the operative regulations as a whole, we do not consider that FAR 31.205-16(e) creates an *implied* mass or extraordinary sale exception to use of the measurement formula as argued by the government. The operative language of FAR 31.205-16(e) provides that "Gains and losses arising from mass or extraordinary sales . . . shall be considered on a case-by-case basis." It is more reasonable to read that sentence as addressing gains or losses previously measured in accordance with paragraph (b) than construing it as an implied exception to (b). The language "shall be considered" in FAR 31.205-16(e) is not sufficiently specific and directive to conclude that the measurement formula prescribed in both FAR 31.205-16(b) and CAS 409.50(j)(1) is superseded. It is more reasonable to read paragraph (e) as addressing issues such as assignment or allocation that are not covered by other mandatory provisions of FAR 31.205-16.

This is not to say that the parties cannot voluntarily negotiate all accounting issues related to mass or extraordinary dispositions as permitted by CAS 409.50(j)(3). We hold only that where as here the "net amount realized" (and gain or loss) on disposition of depreciable assets is readily determinable, that amount will govern unless the parties agree otherwise. Where the net amount realized is not readily determinable from the terms and surrounding circumstances of an arm's length sale of multiple assets, it may make little substantive difference whether the measurement formula is used or the parties negotiate pursuant to the mass/extraordinary disposition provisions. In either case, various substitute methods of apportioning the lump sum proceeds may be relied on to approximate the gain or loss attributable to assets comprising the group sold.

The government relies on our decision in *General Dynamics Electronic Div.*, ASBCA No. 22995, 80-2 BCA ¶ 14,666 for its position that the amount of the loss must be "equitably" negotiated under FAR 31.205-16(e). The *General Dynamics* case involved the contractor's sale of a 56 acre, phased-out plant complex in one transaction in a single fiscal year. Unlike in this case, the net amount realized for the plant, equipment and land were not readily determinable from the sales transaction and surrounding circumstances. Subsequent to the sale, the contractor ordered an appraisal of the land that fixed the value of the land at 34 times its original acquisition cost. The contractor used the appraisal as the basis for determining its capital loss on the plant and equipment for federal tax treatment of the sale. It also sought to use the results of the appraisal in apportioning the total proceeds paid for the plant among the depreciable and non depreciable (land) assets for determining gains or losses for government contract accounting purposes under ASPR 15-205.32, GAINS AND LOSSES ON DISPOSITION OF DEPRECIABLE PROPERTY OR OTHER CAPITAL ASSETS, dated 16 April 1973. ASPR 15-205.32, a predecessor to the FAR provisions involved in this case, permitted, *inter alia*, use of losses recognized for federal income tax purposes in measuring losses for cost allowability purposes. The losses in the case were not measured pursuant to the "net amount realized" formula. Neither party disputed that the sale qualified as a mass or extraordinary disposition. The Board concluded that the gain or loss was required to be "considered on a case-by-case basis" under ASPR 15-205.32(f) and remanded the case to the parties to negotiate the amount of the allowable gains/losses.

Assuming without deciding that the sales (collectively or individually) of the six parcels of LMC's large Sunnyvale campus were mass or extraordinary sales, the *General*

Dynamics decision is nevertheless inapposite. Most significantly, the sales are now covered by CAS 409, which was not involved in *General Dynamics*, as well as FAR 31.205-16. We have detailed above the reasons for our conclusion that FAR 31.205-16(e) does not override the measurement formula of CAS 409.50(j)(1), as well as FAR 31.205 -16(b), particularly given the non-mandatory language of CAS 409.50(j)(3).

Moreover, the scope of the *General Dynamics* appeal did not encompass quantum as does the instant appeal. The government's suggestion that we should remand for further negotiations in accordance with the *General Dynamics,* case lacks merit. Because the appeal includes determination of quantum, it was incumbent on the government to present its best case on the amount of recovery as well as entitlement. The primary quantum position that it currently advocates is that the net book values of the buildings should be inserted in the CAS/FAR measurement formula as the "net amount realized" or that the sales should be regarded as mass/extraordinary dispositions under FAR 31.205-6(e) and the "net book values" should be "considered" as the basis for any quantum award. In either case, the government argues that "zero gain, zero loss" should be recognized.

We have rejected the government interpretations of the governing CAS and FAR provisions. Nevertheless and assuming *arguendo* that the sales here qualify as mass or extraordinary sales and, further assuming that FAR 31.205-16(e) supersedes mandatory use of the measurement formula prescribed in FAR 31.205-16(b) and CAS 409(j)(1), we would conclude after consideration on a case by case basis under FAR 31.205-16(e) that appellant must prevail here.

An implicit assumption made by the government is that the results of market-based determinations of the "net amount realized" in arm's length transactions are somehow inequitable or unfair. That assumption is illogical and contrary to the intent of the regulations as well as GAAP. There is no convincing reason that market-based measurement results should not control, or that the economic substance of the transactions should not be effectuated in accounting for them in the circumstances and on the evidentiary record in this case. In short, there is no reason not to accept the "net amount realized" measured as discussed above in accordance with FAR 31.205-16(b) even if these sales are "considered" under FAR 31.205-16(e).

The government has also been inconsistent in its choice and advocacy of more "equitable" valuation methodologies. The contracting officer initially considered that appraisal evidence of the pre-sale values of the buildings was the fairest procedure. His final decision flatly rejected use of net book values as producing "unreasonable" and "inequitable" results. At the hearing, the contracting officer reversed his position and advocated the use of net book values while distancing himself from the expert appraisals results that the government offered into evidence.

Because of our conclusions above regarding the importance of the measurement formula, it has been unnecessary to make detailed findings concerning all of the appraisal evidence. However, we have analyzed and reviewed that evidence and concluded that the appraisal prepared by appellant's expert, Mr. Hulberg, is the most persuasive in the record. The Hulberg appraisal substantiates the conclusion that the buildings had no value in the Silicon Valley market place. It corroborates and details reasons for the results of the FAR/CAS measurement formula. Factually, the use of appraisals advocated by the contracting officer in his final decision supports the "equity" of the measurement formula in this case.

The government's advocacy in this case of the use of net book values inequitably precludes the contractor from recognizing any loss on disposition. The estimates surrounding depreciation-related valuations and resulting net book values of long-lived assets are particularly imprecise in government contract accounting because contractors are not permitted to write down assets to reflect impairment losses under FAR 31.205-16(g), including those associated with "idle facilities arising from a declining business base." The estimated useful lives of these buildings were inaccurate. Defense industry downsizing and consolidation rendered them prematurely excess to LMC's needs. Under CAS 409.50(j)(1) and FAR 31.205-16(b), the losses "shall be considered as adjustments of depreciation costs previously recognized" only upon actual disposition. We also note that there is no evidence that the proportionate mix of appellant's government and commercial business has materially changed during the period in which the buildings were in use.

Underlying the government's perception of the "equities" is its conviction that the buildings had "value" because LMC occupied and was using many of the buildings prior to sale. From this, Professor Siegel concludes that the buildings contributed to appellant's income or "cash flow." There is no question that some of the buildings on LMC's extensive Sunnyvale campus were excess. DCAA so concluded and strongly recommended that LMC downsize and eliminate the excess capacity. In the ensuing downsizing environment during which these sales were consummated, there is particularly no proof that the buildings contributed *positively* to LMC's "cash flow." Professor Siegel offers no methodology for quantifying how sold buildings on any of the parcels contributed *positively* to LMC's income. There is also no evidence that Professor Siegel analyzed the costs associated with each building that *negatively* contributed to "cash flows." The building-related cost savings are documented in the record. These savings are estimated to exceed the government's share of all of the losses claimed by appellant in these appeals (finding 62).

Considering all of the facts in this case, we conclude that the entire amount paid by the buyers and received by LMC for the six parcels should be apportioned to the land even if the sales were treated as mass or extraordinary sales.

CONCLUSION

The net cash proceeds realized for the six sold parcels were properly apportioned to the land and the net book values of the buildings were properly treated as losses on disposition of the parcels in accordance with FAR 31.205-16(b) and CAS 409.50(j)(1) to the extent of the cash received. However, we remand to the parties for negotiation, issues related to whether LMC received additional non cash consideration associated with the lease back of buildings on two of the parcels. To the extent that appellant received additional consideration related to its post sale leasehold interests, the amount of the losses associated with these parcels should be reduced commensurately.

The appeal is sustained to the extent indicated and remanded to the parties for negotiation solely of the narrow issues described herein.

Dated: 11 October 2007

ROBERT T. PEACOCK
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

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

I concur

JACK DELMAN
Administrative Judge
Acting Vice Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 54169, Appeal of Lockheed Martin Corporation, rendered in conformance with the Board's Charter.

Dated:

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