

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --)
)
Raytheon Company) ASBCA No. 56701
)
Under Contract Nos. DAAH01-03-C-0020)
DAAH01-03-C-0197)

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OPINION BY ADMINISTRATIVE JUDGE FREEMAN

Raytheon Company (Raytheon) appeals a final decision reducing the prices of its CAS-covered fixed-price contracts and the fees of its CAS-covered flexibly-priced contracts that were affected by a voluntary accounting practice change. The captioned contracts are representative of the two classes of contract on which the reductions are claimed. On cross-motions for summary judgment, we find no genuine issues of material fact and Raytheon entitled to judgment as a matter of law.¹

STATEMENT OF FACTS (SOF) FOR PURPOSES OF THE MOTIONS

1. At all times relevant to this appeal, Raytheon has had a number of fixed-price and flexibly-priced contracts with the government that are subject to cost accounting

¹ Appellant also moves to strike a declaration of the Corporate Administrative Contracting Officer offered by the government in partial response to an order to the parties to supplement the appeal (Rule 4) file with certain “records” pertaining to the solicitation and award of the captioned contracts. We find the declaration argumentative and not responsive to the order for “records.” Therefore, we grant the motion to strike.

standards (CAS) pursuant to 41 U.S.C. § 422² and the implementing regulations promulgated by the CAS Board (CASB) thereunder.

2. At all times relevant to this appeal, Raytheon has maintained a pension plan for salaried employees called the Raytheon Salaried Plan (RSP). The actuarial value of the assets (AVA) in the RSP is calculated periodically and used by Raytheon in determining the monetary contribution necessary to meet the plan's present and future obligations. From 1978 to 1 January 2004, the RSP AVA was calculated by Raytheon using the Long Range Yield Method (LRYM) (R4, tab 7 at 8; Joint Stipulations of Fact (stips.) 1, 4)³

3. On 3 October 2001, Raytheon recommended to the government a change in the RSP AVA calculation method and a change in the RSP funding method. These changes as initially recommended by Raytheon were to be retroactive to 1 January 2001. (R4, tab 206 at 1; stip. 6) Raytheon's recommendation for the AVA calculation change stated in pertinent part:

Change in Actuarial Asset Valuation Method

...The [RSP] uses a method that does not efficiently smooth asset gains and losses into the future. We propose to change the asset [actuarial valuation] method to what is known as the 5-Year Smoothed Market Value Method with Phase-In....

...For the [RSP], there could be a significant decrease to CAS reimbursable expense if we change to the proposed method. Because of poor asset returns in 2000 and 2001, we project that the plan will come out of CAS full funding in 2005.... If we change to the proposed method, we project that the [RSP] will remain in CAS full funding for the next ten years, which will result in CAS expense of \$0 for this period....

Impact on Government Contracts

It should be noted that no pension cost is currently being priced into new contracts for either of these plans. Raytheon has not included costs for the [RSP] in contract prices since 1993.... The

² Effective 4 January 2011, 41 U.S.C. § 422 was re-codified as 41 U.S.C §§ 1501-1506, with no substantive change. *See* H.R. Rep. No. 111-42 at 3. Since all relevant events in this appeal occurred and the briefs on the motions were filed before the re-codification, we use the prior code references.

³ Page references for Rule 4 documents cited in this decision are numbered consecutively from the first to last printed page in each Rule 4 tab and are not always the same as the printed page number on any particular document in the tab.

end result of these changes is to keep the assignable cost limitation at \$0, thus resulting in the continuation of \$0 government reimbursable expense.

Conclusion

Our projections show that given recent poor asset returns these plans will come out of full funding using the current asset and liability methodology. If Raytheon changes to the proposed methodology, the [RSP] will remain in CAS full funding for the foreseeable future....

(R4, tab 206 at 3-4)

4. Raytheon's cost impact proposal for the recommended RSP accounting practice changes showed that, if the changes were approved, there would be no CAS funding requirement for the RSP for the years 2001-2010 (R4, tab 208 at 15). On 23 July 2002, the Defense Contract Management Agency (DCMA) Contractor Insurance/Pension Review (CIPR) Center recommended that the government accept Raytheon's proposed RSP accounting practice changes (R4, tab 208 at 10, 13; stip. 7).

5. On 14 November 2002, the government awarded Contract No. DAAH01-03-C-0020 (Contract 0020) to Raytheon for specified services in connection with the Patriot missile system. This was a negotiated cost-plus-incentive-fee contract. It included, among other provisions, the FAR 52.230-2, COST ACCOUNTING STANDARDS (APR 1998) clause (hereinafter "the CAS clause"). The CAS clause, among other things, incorporated by reference the provisions of 48 C.F.R. Part 9903. The contract also included options which, if exercised, would extend the contract completion date to 31 May 2006. (R4, tab 1 at 1, 20, 30)

6. On 31 March 2003, a Defense Contract Audit Agency (DCAA) report stated that Raytheon's cost impact proposal for its recommended RSP accounting practice changes was "reasonable and acceptable for use as a basis for negotiation" (R4, tab 208 at 1, 3).

7. By letter to Raytheon dated 22 April 2003, the DCMA Corporate Administrative Contracting Officer (CACO) approved the proposed 5-Year Smoothed Market Value Method with Phase-In (5YSM) in place of the LRYM for calculating the RSP AVA. The CACO also approved the proposed RSP funding method change. With respect to the cost impact of these changes the CACO stated:

[T]he undersigned has determined that the GDM analysis shows no increased cost in aggregate to the Government. Accordingly, cost/price adjustments (to any Government contracts) are not deemed necessary as a result of the Company's implementation

of the applicable accounting practice changes. This determination of no increased costs in aggregate to the Government represents the full, final, and complete settlement of the GDM analysis (to Government contracts) that is associated with the applicable accounting practice changes. As a result of the above referenced actions, the applicable accounting practice changes are considered to be fully resolved.

(R4, tab 3 at 1-2)

8. On 22 September 2003, the government awarded Contract No. DAAH01-03-C-0197 (Contract 0197) to Raytheon for various electronic parts and services. This was a negotiated firm fixed-price contract. The contract included among other provisions the same CAS clause as Contract 0020. The final contract delivery/performance completion date for the 40 line items in the Schedule was 30 September 2006. (R4, tab 2 at 1-2, 4-35, 44)

9. Due to the delay in receiving government approval for the recommended RSP accounting practice changes, Raytheon did not implement those changes until 1 January 2004. On 14 January 2004, after learning that the RSP accounting practice changes had not been implemented on 1 January 2001, the CACO issued an “initial determination” that the continued use of the LRYM calculation after 1 January 2001 was a CAS non-compliance and directed Raytheon to submit a General Dollar Magnitude (GDM) estimate of the cost impact of the alleged non-compliance. (R4, tab 5 at 1, 7) However, by letter dated 8 February 2005, the CACO withdrew his claim of a CAS non-compliance, agreed to accept 1 January 2004 as the date for implementing the RSP AVA accounting practice change from the LRYM to the 5YSM, and instructed Raytheon to submit a GDM estimate of the cost impact of the change (R4, tab 13).

10. On 14 June 2005, Raytheon submitted its GDM of the cost impact resulting from the RSP AVA change for the years 2004 through 2007 on all CAS-covered contracts in force on 1 January 2004 (R4, tab 17). Raytheon’s GDM estimated a decrease in allocable RSP costs resulting from the change of \$35,631,301 for its fixed-price contracts and \$48,378,523 for its flexibly-priced contracts. Setting-off the decreased allocations on the fixed-price contracts as an increased cost to the government against the larger decreased cost allocations on the flexibly-priced contracts,⁴ Raytheon’s GDM showed no aggregate increased cost of the accounting change to the government. (R4, tab 17)

⁴ The reason for treating the impact of the decreased cost allocations on the existing fixed-price contracts as an increased cost to the government is that if the changed practice had been in effect when the fixed-price contracts were negotiated, the negotiated fixed prices would have been lowered by the amount of the decreased cost allocations.

11. On 2 August 2005, the DCMA CIPR Center issued a report to the CACO on Raytheon's 14 June 2005 GDM. The CIPR Center report concluded that:

The CIPR Center finds that both the LRYM and 5 Year Smoothed Actuarial Asset Value methodologies are actuarially sound and determine a different funding stream or annual cost requirement over the short run, current Brochure 5 year forward pricing period.

The CIPR Center has no objection to implementation of the applicable five year Deferred Recognition smoothing methodology for calculating the Actuarial Value of Assets for the Raytheon Salaries Pension Plan with a "Fresh Start" date of 1 January 2004 for all future CAS cost forward pricing purposes.

(R4, tab 18 at 1, 5)

12. On 22 February 2007, the DCAA issued an audit report on Raytheon's 14 June 2005 GDM. For the four-year period 2004 through 2007, the audit report estimated that the accounting change resulted in a \$57,209,821 decrease in RSP cost allocable to the flexibly-priced contracts, and a \$31,402,263 decrease in RSP cost allocable to the fixed-price contracts. As in Raytheon's GDM, the DCAA audit considered the impact of the decreased cost on the fixed-price contracts to be an increased cost to the government. The DCAA audit report also calculated a \$9,287,125 increased cost to the government for the impact of the decreased RSP allocable cost on the amounts negotiated before the change for the fixed-price contract profits and flexibly-priced contract fees. (R4, tab 20 at 1, 6, 16)

13. The DCAA report, however, did not set-off its total estimated \$40,689,388⁵ increased cost to the government on the fixed-price contract costs, profits and flexibly-priced contract fees against its estimated \$57,209,821 decreased cost to the government on the flexibly-priced contract reimbursable costs. It accordingly concluded that the RSP AVA accounting practice change resulted in an increased cost in the aggregate to the government of \$40,689,388. (R4, tab 20 at 6) The stated justification in the audit report for not making the set-off was as follows:

Raytheon offset increased costs on fixed-price contracts with decreased costs on flexibly priced contracts. We consider this to be inappropriate in this circumstance because Raytheon's change in how pension costs are measured results in a reduction of

⁵ \$31,402,263 + \$9,287,125.

pension costs over the first five years (2005-2009). However there is a subsequent increase in future years that completely offsets the reduction. During the period when existing contracts are being completed, cost type contracts will have reduced pension cost allocations of \$57.2 million. The Government will recover the reduced allocations on cost type contracts through the normal billing process. Fixed-price contracts will receive decreased allocations of \$31.4 million. Unless FFP contracts are modified (reduced) by \$31.4 million, Raytheon will effectively receive a windfall profit of \$31.4 million. We believe it is a windfall because existing contracts end before the additional pension costs resulting from the accounting charge [sic] are incurred. Thus, the additional pension costs will be allocated to future contracts and Raytheon will have the opportunity to recover those costs through the initial pricing. Raytheon contends that future contracts cannot be adjusted for increased costs. We agree, however the contracting officer should – must consider the windfall profit Raytheon is generating by this very advantageous change, when determining how to adjust existing contracts.

(R4, tab 20 at 3)⁶

14. By final decision dated 8 October 2008, the CACO adopted the findings and conclusions of the DCAA audit report, and demanded payment by Raytheon of \$40,689,388 with compound interest from 27 January 2005 as a price adjustment for the increased cost to the government, in the aggregate, of the RSP AVA accounting practice change. In this decision the CACO stated among other things that (i) the change was not a desirable change for the government because the reduced pension costs in the first five years (2004-2008) would be increased in subsequent years in amounts “completely offsetting the reduction”⁷; (ii) the change resulted in a “windfall” profit for Raytheon on its current fixed-price contract prices and flexibly-priced contract fees; and (iii) the change would result in double-charging because the RSP pension costs already embedded in the fixed price contracts, but not paid by Raytheon, have been merely deferred to a

⁶ The audit narrative quoted above refers to the “five years (2005-2009)” as the period of reduced pension cost allocations caused by the change. However, the audit calculated amount of the reduced pension cost allocations on which the government’s present claim is based is for the four-year period 2004-2007 (R4 tab 20 at 6).

⁷ The CACO adopted without change the amount of the increased cost to the government alleged in the DCAA audit report which was based on the four year period 2004-2007 (R4, tab 26 at 3). *See* note 5 above.

later time period in which they will again be charged to government contracts in that later period. (R4, tab 26) This appeal followed.

15. The government moves for summary judgment on the grounds that (i) Raytheon's calculation of the increased cost to the government of the accounting change ignores the actual pension costs; (ii) the government's calculation provides consistency between Raytheon's actual pension costs and the amount it is reimbursed by the government for those costs; and (iii) the law requires re-pricing of fixed-price contracts when the government pays increased costs as a result of the contractor's accounting change (gov't mot. at i).

16. Raytheon opposes the government motion and cross-moves for summary judgment on the grounds that (i) the accounting change was a "Desirable Change" for which applicable regulations permit increased cost to the government without price adjustment; (ii) applicable statute, regulations and judicial precedent require consideration of all contracts "affected" by the change and the set-off of increased cost on some contracts against the decreased cost on other contracts to determine the aggregate increased cost to the government; and (iii) the government's citation of equity is merely an excuse to disregard applicable law (app. mot. at i, ii).

DECISION

On the record before us on the motions, there is no genuine issue of material fact that the change from the LRYM to the 5YSM calculation of the RSP AVA resulted in lower allocations of RSP pension cost to all of Raytheon's CAS-covered contracts for the period 2004-2007 than otherwise would have been allocated if the change had not occurred. There is also no genuine issue of material fact that, as estimated by both parties, the decreased cost to the government of the change on the flexibly-priced contract costs was greater than the increased cost to the government of the change on the fixed-price contract costs, profits and flexibly priced contract fees. Moreover, even if the additional increased cost of \$9,287,125 in the government estimate for the impact of the change on the fixed-price contract profits and flexibly-priced contract fees is added to the Raytheon estimate of increased costs, that total increased cost estimate would still be less than either parties' estimate of the decreased costs to the government on the flexibly-priced contract costs. (SOF ¶¶ 10, 12)

The statutory provisions for price adjustment for increased costs paid by the government on a contract subject to CAS as a result of a cost accounting change by the contractor are set forth in 41 U.S.C § 422(h)(1) and (3) in relevant part as follows:

(h) Implementing regulations

(1) The [CAS] Board shall promulgate rules and regulations for the implementation of cost accounting standards promulgated or interpreted under subsection (f) of this section. Such regulations shall be incorporated into the Federal Acquisition Regulation and shall require contractors and subcontractors as a condition of contracting with the United States to—

....

(B) agree to a contract price adjustment, with interest, for any increased costs paid to such contractor or subcontractor by the United States by reason of a change in the contractor's or subcontractor's cost accounting practices...

....

(3) Any contract price adjustment undertaken pursuant to paragraph (1)(B) shall be made, where applicable, on relevant contracts between the United States and the contractor that are subject to the cost accounting standards so as to protect the United States from payment, in the aggregate, of increased costs (as defined by the [CAS] Board). In no case shall the Government recover costs greater than the increased cost (as defined by the [CAS] Board) to the Government, in the aggregate, on the relevant contracts subject to the price adjustment, unless the contractor made a change in its cost accounting practices of which it was aware or should have been aware at the time of the price negotiation and which it failed to disclose to the Government.

41 U.S.C § 422(h)(1) and (3).

At the time the representative contracts in this appeal were entered into, the CASB regulations for price adjustments for voluntary accounting practice changes stated in relevant part:

(a) Increased costs shall be deemed to have resulted whenever the cost paid by the Government results from a change in a contractor's cost accounting practices...and such cost is higher than it would have been had the practices not been changed....

....

(e) An adjustment to the contract price or of cost allowances pursuant to the Cost Accounting Standards clause at 9903.201-4(a) may not be required when a change in cost accounting practices or a failure to follow Standards or cost accounting practices is estimated to result in increased costs being paid under a particular contract by the United States. This circumstance may arise when a contractor is performing two or more covered contracts, and the change or failure affects all such contracts. The change or failure may increase the cost paid under one or more of the contracts, while decreasing the cost paid under one or more of the contracts. *In such case, the Government will not require price adjustment for any increased costs paid by the United States, so long as the cost decreases under one or more contracts are at least equal to the increased cost under the other affected contracts*, provided that the contractor and the affected contracting officers agree on the method by which the price adjustments are to be made for all affected contracts. [Emphasis added]

48 C.F.R. § 9903.306(a) and (e) (Oct. 1, 2001).⁸

For the Raytheon contracts in performance when the change was implemented, the accounting practice change at issue had an increased cost impact on the government on the fixed-price contract costs and profits and flexibly-priced contract-fees, and a decreased cost impact on the government on the flexibly-priced contract reimbursable costs. This situation, where an accounting change causes increased costs to the government on some contracts and decreased costs on other contracts, is expressly addressed in the above-quoted provisions of 48 C.F.R. § 9903.306(e) implementing the statutory provisions in 41 U.S.C § 422(h)(3). The statute expressly provides that a price adjustment for a contractor's accounting practice change is "to protect the United States from payment, in the aggregate, of increased costs" and that "[i]n no case shall the Government recover costs greater than the increased cost...in the aggregate, on the

⁸ These regulations are also expressly incorporated into the representative contracts by the FAR 52.230-2 CAS clause in each contract (*see* SOF ¶¶ 5, 8).

relevant contracts subject to the price adjustment.” *See Lockheed Martin Corp. v. United States*, 70 Cl. Ct. 745, 751-53 (2006).

The government argues that the set-off required by the statute and regulation ignores actual pension costs and that the government calculation, which makes no set-off, provides consistency between the actual pension costs and the amounts the government pays for those costs. In explanation of its consistency argument, the government states that, on the fixed-price contracts the contractor is reimbursed on the basis of price but does not pay the pension cost component in that price. The government then states that, since it pays only the allocable cost on the flexibly-priced contracts, there is no underpayment of costs on those contracts against which the overpayment of costs on the fixed-price contracts can be set-off. (Gov’t mot. at 16-17) The fact that the government may not underpay the allocable costs on the flexibly-priced contracts resulting from the accounting change, however, does not change the fact that those allocable costs (as calculated by the government) would have been \$57,209,821 higher if the accounting change had not been made.

The government further argues that (i) the law requires re-pricing fixed-price contracts when the government pays increased costs as a result of the contractor’s accounting change, (ii) Raytheon’s calculation provides a “windfall” profit on the fixed-price contracts and (iii) Raytheon’s calculation creates an opportunity for Raytheon to charge to some future contract the same pension costs that were embedded in the present fixed-priced contract prices.


We find no merit in these arguments. The law requires a price adjustment for an accounting change only when the government pays increased cost “in the aggregate” considering all contracts affected by the change. Insofar as a windfall profit unanticipated at award is concerned, the unanticipated \$40,689,388 windfall profit for Raytheon on the fixed-price contracts is substantially exceeded by the \$57,209,821 windfall reduction in cost to the government, unanticipated at award, on the flexibly-priced contracts. The argument of potential double charging is entirely speculative as to future pension fund performance and future contracts. In any event the price adjustment for consideration here is limited to the CAS-covered contracts in effect at the time the accounting change was made. There is nothing in the record suggesting any double charging of pension costs to those contracts

Considering the express and unambiguous provisions of 41 U.S.C § 422(h)(3) and 48 C.F.R. § 9903.306(e), all of the government arguments appear to be addressed to the wisdom and policy of the statute and regulation. Our role, however, is to apply the statute and regulations and not to determine whether some other approach would be better. *See McDonnell Douglas Corp.*, ASBCA No. 19842, 80-1 BCA ¶ 14,223 at 70,052.

On the undisputed material facts and pursuant to the CASB regulations, Raytheon's RSP AVA accounting practice change did not result in any increased cost, in the aggregate, to the government on the CAS-covered contracts in effect on the date of the change. In light of that conclusion, we see no need to address the "desirable change" issue raised by appellant. The government's motion for summary judgment is denied. Appellant's motion for summary judgment is granted.

The appeal is sustained.


Dated: 31 March 2011



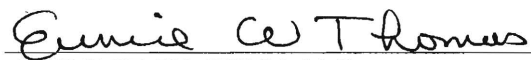
MONROE E. FREEMAN, JR.
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

I concur



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



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

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 56701, Appeal of Raytheon Company, rendered in conformance with the Board's Charter.

Dated:

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