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Decisions

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COFC Reconsiders CAS 413 Ruling

CBS Corp. v. U.S., 2007 WL 570007 (Fed. Cl. Feb. 21, 2007)

The U.S. Court of Federal Claims has reconsidered a previous decision addressing rules governing the accounting treatment of subcontract-related pension costs as part of the pension-cost adjustment that occurs when a contractor sells a business unit. Reversing its May 8, 2006 decision, the COFC concluded that the 1995 revision to Cost Accounting Standard 413 did not change the original CAS 413 treatment of pension costs attributable to subcontracts. Thus, revised CAS 413 did not necessitate a change in accounting practice, and the Government was not entitled to an equitable adjustment to account for higher pension contributions attributable to a mandatory accounting change.

Under CAS 413, a cost adjustment is made when a segment closes to correct any over- or under-contribution to a pension fund. The Government can recoup its share of a surplus, and must pay its share of a deficit. Two business units of Viacom Inc. had pension deficits when they were sold—one sale occurred prior to the 1995 revision to CAS 413, and the other sale occurred after the revision took effect—and Viacom, now CBS as the result of a merger, sued to recover the Government's share of the deficit. The parties' dispute centered on how the original and revised CAS 413 operate and how revised CAS 413 affects a pension deficit attributable, in part, to contracts entered into under original CAS 413.

The May 8 Decision—Consistent with its previous ruling in *General Motors Corp. v. U.S.*, 66 Fed. Cl. 153 (2005); 47 GC ¶ 340; the Court's May

8, 2006 decision held that a segment-closing adjustment under either original or revised CAS 413 is not barred by (1) failure to fund claimed pension costs, (2) failure to give Limitation of Funds (LOF) or Limitation of Costs (LOC) clause notices, or (3) a general release. Following its interpretation of CAS 413 in *Teledyne Inc. v. U.S.*, 50 Fed. Cl. 155 (2001), aff'd, 316 F.3d 1366 (Fed. Cir. 2003); 45 GC ¶ 69, a case involving a Government claim for a pension surplus, the COFC held that no adjustment is due under original CAS 413 for the portion of a pension surplus or deficit attributable to fixed price contracts, contracts awarded prior to the effective date of original CAS 413, or employee contributions.

In addition, the COFC held that applying revised CAS 413 to pension costs attributable to contracts entered into under original CAS 413 requires an equitable adjustment under paragraph (a)(4)(i) of Federal Acquisition Regulation 52.230-2, Cost Accounting Standards (CAS clause). The CAS clause calls for an equitable adjustment if a contract cost is affected by a change in accounting practice mandated by the clause's provision requiring the contractor to "comply with any CAS (or modifications to the CAS) which hereafter become applicable to a contract or subcontract" The Court held that under this provision, the Government is entitled to an equitable adjustment for pension-deficit liability that is greater under revised CAS 413 than it would have been under original CAS 413. See *Viacom, Inc. v. U.S.*, 70 Fed. Cl. 649 (2006); 48 GC ¶ 219.

Addressing a previously unresolved issue, the May 8, 2006 decision held that original CAS 413 did not provide for recovery of a pension deficit or surplus attributable to Government subcontracts. Because revised CAS 413 expressly includes subcontracts in a segment-closing adjustment, the Government was entitled to an equitable adjustment under the CAS clause for the part of the pension deficit attributable to subcontracts under original CAS 413.

The Reconsideration Decision—On reconsideration, the Court reversed its decision on the subcontract issue. In the May 8 ruling that pension

costs attributable to subcontracts were not recoverable in a segment-closing adjustment under original CAS 413, the Court relied primarily on the absence of an express reference to subcontracts in original CAS 413 and the fact that subcontract pension costs are paid by the prime contractor rather than by the Government. The May 8 decision also reasoned that subcontracts are similar to fixed price contracts and, absent an express mention of subcontracts in original CAS 413, there would be no basis to conclude that pension costs attributable to subcontracts would be recoverable.

The reconsideration decision stated that equating pension costs attributable to fixed-price contracts and pension costs attributable to flexibly priced contracts “was not appropriate.” In contrast to fixed-price contracts, for which there is no basis for an adjustment, flexibly priced subcontracts were potentially subject to a segment-closing adjustment. CAS rules apply to subcontracts and prime contracts, and the statutes authorizing the CAS Board and CAS regulations make clear that subcontract and prime contract costs are treated the same. See 50 USCA app. § 21689(g) (repealed); 41 USCA § 422 (f)(2)(A) (1988). Therefore, a contractor would have expected that a segment closing under original CAS 413 would include adjustments to pension costs attributable to flexibly priced prime contracts or flexibly priced subcontracts.

This view is consistent with the regulatory history of revised CAS 413, which characterized the recovery of pension costs attributable to fixed-price contracts as a change but did not describe the recovery of pension costs attributable to subcontracts as a change, the Court said. In addition, the Defense Contract Management Agency and Defense Contract Audit Agency took the same view in their joint audit guidance covering CAS 413 segment closings. Although the Court was not bound by the DCMA-DCAA guidance, it was “persuasive evidence” that the Government and contractors expected that pension costs attributable to cost-type subcontracts under original CAS 413 would be included in an adjustment under revised CAS 413 without the need for an equitable adjustment.

The Court concluded that including pension costs attributable to flexibly priced subcontracts in a segment-closing adjustment under revised CAS 413 is not a change from original CAS 413, and the Government was not entitled to an equitable adjustment under the CAS clause.

◆ **Practitioner’s Comment**—The Court’s reconsideration decision corrects a portion of the May 8 ruling that would have had very unfair results for contractors. Government segment-closing claims under original CAS 413 have always included pension costs attributable to both contracts and subcontracts. Indeed, excluding the portion of a pension surplus or deficit attributable to subcontracts would conflict with the plain language of the standard. Although original CAS 413 does not mention subcontracts, neither does it exclude them. The “difference between the actuarial accrued liability for the segment and the market value of the assets allocated to the segment” necessarily includes the entire amount of the surplus or deficit, regardless of the origin of the pension contributions that gave rise to it, because original CAS 413 does not require or permit any adjustments to the assets or the liabilities before subtracting the liabilities from the assets. Thus, there is simply no basis in the language of original CAS 413 for excluding the portion of a surplus or deficit attributable to subcontracts from the segment closing adjustment.

Because it has been more than 10 years since CAS 413 was revised and because pension costs attributable to subcontracts are expressly included in the segment-closing adjustment formula under the revised standard, the subcontracts issue may not at first appear to be of much practical significance. However, pretending that subcontracts are not included in the segment closing adjustment under original CAS 413 artificially increases the amount of the equitable adjustment the Government would receive when revised CAS 413 is applied to pension costs attributable to contracts entered into under original CAS 413.

There is considerable reason to question whether an equitable adjustment is even applicable to a segment closing under revised CAS 413. The CAS clause’s equitable adjustment provision applies only (1) when the contractor is required to make an accounting practice change as a result of the issuance of a new standard, and (2) to contracts awarded prior to the effective date of the new standard. In contrast to the pension cost adjustment under original CAS 413, the segment-closing adjustment under revised CAS 413 is computed according to a formula and “may be recognized by modifying a single contract, several but not all contracts, or all contracts, or by use of any other suitable technique.” Accordingly, if the segment-closing adjustment were made under a contract awarded after the effective date of revised CAS

413, there would be no triggering event for the CAS clause's equitable adjustment provision. Nevertheless, to the extent that an equitable adjustment applies, it should at least be computed properly. For that reason, the Court's reconsideration decision is a significant improvement over the May 8 decision.



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