GOVERNMENT CLAIMS TO SURPLUS PENSION ASSETS

Karen L. Manos

I. INTRODUCTION

During the early 1980s, the defined benefit pension plans maintained by many defense contractors became significantly overfunded. The pension surplus resulted primarily from the unexpectedly robust growth of the stock market, and to a lesser extent from the shrinking defense industry workforce, dampened wage inflation for salaried employees below the corporate executive level, funding requirements imposed by the Employee Retirement Income Security Act (ERISA) of 1974, and government contracting regulations.1 During this same period, some contractors terminated their defined benefit pension plans in order to gain access to the plans’ surplus funds.2 The Government, in turn, began a concerted effort to recover what it viewed as its “equitable share” of the surplus funds.3

At first, the Government limited its claims for surplus pension assets to plan terminations that resulted in a reversion of plan assets to the contractor. The Government based its claims on then-existing Armed Services Procurement Regulation (ASPR) and Defense Acquisition Regulation (DAR) provisions and contract clauses, including, in particular, the Credits provision, the Allowable Cost, Fixed Fee and Payment clause (now called the Allowable Cost and Payment clause), and the Incentive Price Revision clause. Next, the Government sought to protect its share in the reversions by attempting to negotiate advance agreements with contractors, or by including special savings clauses in negotiated contracts.4 Now, after a series of increasingly aggressive amendments to the

Karen L. Manos is a partner in the Washington, D.C. office of Howrey & Simon.

4. See id. at 4; see also DEFENSE CONTRACT AUDIT AGENCY, U.S. DEP’T OF DEFENSE, 1 DCAA CONTRACT AUDIT MANUAL, ¶¶ 7-606.1(f), at 746, 7-606.3a, at 746
Federal Acquisition Regulation (FAR) cost principles and Cost Accounting Standards (CAS or Standards) provisions, the Government has several alternatives upon which to assert claims to contractors' accumulated pension surpluses.

The stakes are potentially huge: the pension plans maintained by defense contractors account for a sizeable portion of the estimated $2 trillion in pension assets currently held in defined benefit pension plans. Indeed, since the mid-1980s many of the largest defense contractors have had billions of dollars of surplus pension assets. Potential government claims for surplus pension assets can exceed, in some cases, the value of a business unit, thus hindering corporate restructuring.

This article examines the alternative bases upon which the Government may assert a claim for surplus pension assets and discusses legal arguments that may be available to defend against such claims. It concludes with an analysis of potential strategies for avoiding, limiting, or delaying government claims to surplus pension assets.

II. BACKGROUND

Applicable laws and regulations generally consider the costs of contractor contributions to employee pension plans "allowable" costs for government contracting purposes; the costs may be reimbursed under a contractor's cost-reimbursement contracts and used in the pricing of fixed-price contracts. There are two basic types of pension plans to which contractors may make contributions: the defined contribution plan and the defined benefit plan. Under a defined contribution pension plan, the amount of the contractor's contribution is established in advance, and the employees' benefits vary based on the pension plan's investment

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5. Cf. Mike Maharry, High Court to Hear Pension-fund Profit Case, Who Gets Pension Assets Totaling $2 Trillion? Workers or Companies?, NEWS TRIB., Nov. 2, 1998, at C8; COST ACCOUNTING STANDARDS BD., DRAFT COST ACCOUNTING STANDARD ON THE ADJUSTMENT AND ALLOCATION OF PENSION COSTS, at 23 (1976) ("In its research on the development of ERISA, the Pension Task Force determined that whereas a great many pension plans of companies engaged in commercial work were underfunded, the opposite situation was prevalent for companies engaged primarily in Government work. These plans were generally either fully-funded or over-funded.").

6. See Stuart Weiss, Fat Pension Funds Can Make Companies Tempting Targets, BUS. WK., Nov. 10, 1986, at 106 (tracking the pension plan surpluses of large companies).
experience. By contrast, under a defined benefit pension plan, the benefits, or basis for determining the benefits, to be paid are established in advance, and the contractor makes contributions in an amount actuarially determined necessary to pay the required benefits as they become due. The actuarial assumptions used in determining the amount of the contractor's contribution commonly include such factors as the interest rate at which the pension assets will grow, mortality rates, retirement age, compensation levels, and employee turnover.

To be tax deductible, a contractor's pension contributions must be made to a qualified pension trust, established for the exclusive benefit of the employees and their beneficiaries. Except for withdrawals permitted to pay current retiree medical expenses under section 420 of the Internal Revenue Code ("IRC 420 transfers"), the contractor may not, without terminating the plan, either withdraw or divert the pension assets before satisfying all of the plan's liabilities to employees and their beneficiaries. Terminating a pension plan without establishing a qualified replacement plan or increasing the employees' accrued benefits subjects the contractor to a 50% excise tax—plus corporate income tax at a rate of up to 35%—on the assets withdrawn.

The amount of pension cost charged to a contractor's government contracts for a defined benefit pension plan is necessarily based on an estimate, as are many other costs of contract performance, such as the costs of materials, fuel, and labor. Consequently, the contractor's actual cost experience may be higher or lower than the amount originally anticipated. Whether the contractor's actual cost experience affects the amount paid under the contract typically depends on the type of contract.

Government contracts may be grouped broadly into two categories: fixed-price contracts and cost-reimbursement contracts. Between these
two extremes are other types of so-called flexibly priced contracts, such as price-redetermination and incentive contracts, that may include features of both fixed-price and cost-reimbursement contracts. Federal Acquisition Regulation (FAR) 16.202-1 provides that the price of a firm-fixed-price (FFP) contract “is not subject to any adjustment on the basis of the contractor’s cost experience in performing the contract.” Rather, a FFP contract “places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss.” Cost-reimbursement contracts, on the other hand, provide for the payment of the contractor’s allowable incurred costs and a pre-established, fixed fee. For contracts with commercial organizations, the FAR cost principles are used to determine whether costs are reimbursable under cost-reimbursement and other flexibly-priced government contracts.

One of the more significant features of the cost principles is the Credits provision, which has been a part of the ASPR, DAR, and FAR since the early 1950s. The FAR cost principles, including the Credits provision, are applicable to cost-reimbursement contracts through inclusion in a contract of the Allowable Cost and Payment clause; to redetermination contracts through inclusion of the Price Redetermination clause; and to incentive contracts through inclusion of the Incentive Price Revision clause. When applicable, the Credits provision requires the contractor to give the Government a credit, by cost reduction or cash refund, of “[t]he applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost” that the contractor either receives or accrues. Echoing this requirement, the Allowable Cost and Payment clause, which has been a part of the ASPR, DAR, and FAR since 1953, requires the contractor to “pay to the Government any refunds, rebates,

15. Id. § 16.202-1.
16. Id.
17. See id. § 16.301-1 (providing a general description of cost-reimbursement contracts).
18. See id. § 31.103.
21. See id. §§ 52.216-5, 52.216-6 (Price Redetermination—Prospective Clause and Price Redetermination—Retroactive Clause, respectively (Oct. 1997)).
22. See id. § 52.216-16 (governing firm targets); see also id. § 52.216-17 (addressing successive targets).
23. Id. § 31.201-5.
24. Originally named the Allowable Cost, Fixed Fee, and Payment clause, and subsequently renamed the Allowable Cost, Fee, and Payment Clause, before being given its current name, Allowable Cost and Payment.
credits, or other amounts (including interest, if any) accruing to or received by the Contractor or any assignee under [the] contract, to the extent that those amounts are properly allocable to costs for which the Contractor has been reimbursed by the Government.\textsuperscript{25}

Moreover, with respect to cost-reimbursement contracts, the Government's rights under the \textit{Credits} provision are plainly intended to survive final contract payment. The \textit{Allowable Cost and Payment} clause requires contractors, as a condition of receiving final payment, to execute an assignment of such amounts allocable to costs reimbursed to the contractor by the Government.\textsuperscript{26} In contrast, the \textit{Incentive Price Revision} clause, which is included in fixed-price incentive contracts, provides that the total final price is not "subject to revision, notwithstanding any changes in the cost of performing the contract," \textit{unless} the parties have specifically agreed in their contract that adjustments or credits are permitted.\textsuperscript{27}

In addition to the FAR cost principles, Cost Accounting Standards (CAS) 412 and 413 govern pension costs — even under contracts not otherwise subject to the Cost Accounting Standards. More particularly, in order to be allowable for government contracting purposes, the costs of a defined benefit pension plan must, among other things, be measured, allocated, and assigned to cost accounting periods in compliance with CAS 412 and 413.\textsuperscript{28} CAS 412 provides "guidance for determining and measuring the components of pension cost . . . [and] establishes the basis on which pension costs shall be assigned to cost accounting periods."\textsuperscript{29} It requires that pension cost for defined benefit pension plans "be determined by use of an immediate-gain actuarial cost method," and that, with limited exceptions, the pension cost be assignable only in the current cost accounting period.\textsuperscript{30} CAS 413 provides "guidance for adjusting pension cost by measuring actuarial gains and losses and assigning such gains and losses to cost accounting periods . . . [and] the bases on which pension cost shall be allocated to segments of an organization."\textsuperscript{31} It requires that the actuarial gains and losses "be calculated annually" and "be assigned to the cost accounting period for which the actuarial valuation is made.

\textsuperscript{25} 48 C.F.R. § 52.216-7(h)(2) (1998).
\textsuperscript{26} See id. § 52.216-7(h)(2)(i) (1998); see also 32 C.F.R. § 7-203.4(L) (1982).
\textsuperscript{27} 48 C.F.R. §§ 52.216-16(e), 52.216-17(g) (1998).
\textsuperscript{28} See id. § 31.205-6(j)(2).
\textsuperscript{29} Id. § 9904.412-20 (defining the purpose of the CAS for composition and measurement of pension costs).
\textsuperscript{30} Id. §§ 9904.412-40(b), (c) (governing the measurement and assignment of pension costs).
\textsuperscript{31} Id. § 9904.413-20 (stating the purpose of adjustment and allocation of pension costs).
and [to] subsequent periods.”

As originally promulgated, CAS 413-50(c)(12) included a so-called "segment closing" provision that specified in part:

If a segment is closed, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated . . . . The difference between the market value of the assets and the actuarial liability for the segment represents an adjustment of previously-determined pension costs.

The term “segment” is defined as “one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service.”

Although the original Standard defines the term “segment,” it does not specify the circumstances under which a segment is to be considered “closed.” Nor does the original Standard more explicitly define the phrase “adjustment of previously-determined pension costs.” Nevertheless, both the plain language of the original Standard and its regulatory history clarify that an “adjustment of previously-determined costs” is intended to be an accounting adjustment (i.e., an adjustment reflected on the contractor’s books of account) of the pension costs previously allocated. Whether the accounting adjustment affects the cost allowance or price of any particular contract depends upon the procurement regulations rather than the CAS.

32. Id. § 9904.413-40.
33. 4 C.F.R. § 413.50(c)(12) (1978).
35. Nevertheless, the sole segment closing illustration in the original Standard supports a literal reading of the term “closed” to mean the cessation of operations. That illustration, originally appearing at CAS 413-60(c)(8), involves a segment performing a single government contract, which the Government declines to renew at the end of the contract term. See 48 C.F.R. § 9904.413-60(c)(8) (1992). As a result, the facility is closed: “Although some employees are hired by the successor contractor, as far as Contractor K is concerned, the facility is closed.” Id. Notably, the segment in the illustration has not been sold or transferred to the successor contractor, and there is no indication that its operations have continued. See id. Rather, it appears from the illustration that the segment has been physically closed, and that its operations have ceased. See id. By contrast, the illustration initially found at CAS 413.609(c)(5), which posits a scenario in which a segment has been acquired by another contractor, neither characterizes the event as a segment closing nor mentions the segment closing provision of CAS 413.50(c)(12). See id. § 9904.413-60(c)(5). Instead, it explains that the acquiring contractor must separately account for the acquired segment’s pension assets and liabilities, pursuant to CAS 413.50(c)(5) and (7), and use this segment accounting as the “basis for calculating the annual pension cost applicable to [the acquired segment].” Id.
Similar to the current Cost Accounting Standards Board (CAS Board), the authority of the Board that originally promulgated CAS 413 was limited to issues of allocability and not allowability. In establishing the original CAS Board, Congress noted that:

The essential problem in cost accounting is to develop methods for allocating expenses to a particular contract. Direct expenses associated with the contract are fairly easy to determine; however, there are a variety of methods for allocating indirect or overhead expenses. Since overhead often represents more than half the cost of a contract, the particular cost accounting method used to allocate overhead charges has a crucial bearing on determining the cost of the contract.

Accordingly, Congress directed the CAS Board to “promulgate cost-accounting standards designed to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts.” Faithful to its charge, the original Board recognized the distinction between allocability and allowability, observing in its 1977 Restatement of Objectives, Policies and Concepts that:

The CASB does not determine categories or individual items of cost that are allowable. Allowability is a procurement concept affecting contract price and in most cases is established in regulatory or contractual provisions. An agency’s policies on allowability of costs may be derived from law and are generally embodied in its procurement regulations . . . .

Allocability is an accounting concept involving the ascertainment of contract cost; it results from a relationship between a cost and a cost objective such that the cost objective appropriately bears all or a portion of the cost. For a particular cost objective to have allocated to it all or part of a cost there should exist a beneficial or causal relationship between the cost objective and the cost.

Consistently, in promulgating CAS 413, the CAS Board deferred to the procurement regulations for the determination of how, if at all, the

accounting adjustment required by CAS 413.50(c)(12) should be made. The CAS Board staff's May 14, 1976 Background Paper, for example, contains an early draft of the segment closing provision that provides:

If all, or substantially all, of a segment is closed, and a significant number of employees are thereby separated from the plan, the contractor shall compute a net gain or loss from the plan applicable to that segment, irrespective of the actuarial cost method used . . . . The net gain (or loss) shall be used as a basis for determining any appropriate adjustments consistent with existing Government contract regulations.40

Similarly, the CAS Board staff's January 3, 1977 Staff Paper observes that:

The proposed Standard provides that the net pension plan gain or loss resulting from the closing of the business unit be considered in arriving at any overall contract settlement price, consistent with existing Government contract regulations. The proposed Standard does not set forth the extent, if any, to which such net gains or losses shall be considered in any settlement.41

As initially proposed, the CAS 413 segment closing provision (then numbered 413.50(c)(13)) would have provided that:

The requirements of paragraphs (c)(1) and (2) of this section are appropriate only for segments whose productive operations are continuing. However, if a segment is closed and a significant number of employees are thereby terminated from the plan, the contractor shall compute a net gain or loss from the plan applicable to that segment, irrespective of whether or not the pension plan is terminated . . . . The net gain or loss from the plan for the segment shall be used as a basis for negotiating any appropriate adjustments.42

The final rule, published on July 20, 1977, omits the requirement for negotiating an adjustment, and provides simply that “[t]he difference between the market value of the assets and the actuarial liability for the segment represents an adjustment of previously-determined pension costs.”43 Accordingly, the rule leaves entirely to the procurement regulations how or whether the “adjustment” affects the cost allowance or price

41. COST ACCOUNTING STANDARDS BD., COST ACCOUNTING STANDARD ADJUSTMENT AND ALLOCATION OF PENSION COST, at 32 (1977).
43. Id. at 37,191, 37,198.
III. CHRONOLOGY OF REGULATORY CHANGES

In February 1987, the Civilian Agency Acquisition Council and the Defense Acquisition Regulatory Council (collectively “FAR Council”) proposed to amend the FAR to establish an express government right to share in the reversion of pension funds to a contractor following the termination of an overfunded defined benefit pension plan. Comments accompanying the proposal asserted that:

Charges for pension costs have been accepted on Government contracts on the basis that funding was irrevocable and therefore that the Government would participate in all gains and losses incurred by pension plans. In recent years, many pension plans have been terminated and excess pension plan assets have reverted to and have been used by the sponsoring company for other purposes. Such proceeds represent an adjustment of prior period's [sic] pension costs.

Accordingly, the drafters proposed adding a new paragraph, (j)(4), to the “Compensation for personal services” cost principle at FAR 31.205-6 that would establish a “method for computing the Government’s equitable share of any such adjustments of prior periods' pension costs.” As initially proposed, the “Government’s share” would have been determined by multiplying the difference between the market value of the plan assets and the termination value of the plan liabilities by “the ratio of pension expense absorbed by all Government contracts and subcontracts (including Foreign Military Sales) to total pension costs incurred during the 10-year period preceding the date of plan termination, or the period from the inception date of the plan being terminated, whichever is shorter.” A proposed new contract clause, Termination of Defined Benefit Pension Plans, was to “trigger” this look-back provision, allowing the Government to share in the proceeds “on a basis proportionate to

45. Id. at 4084.
47. Id. at 4086 (proposed FAR 31.205-6(j)(4)(i)-(ii)). Mathematically, the equation for computing the Government share under the proposed rule is as follows:

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\frac{\text{aggregate amount of pension costs allocated to all government contracts and subcontracts during the ten years preceding the date of plan termination [or the period from the inception date of the plan, whichever is shorter]}}{\text{total pension costs as- signed during the same period}} \times (\text{pension surplus}) = (\text{government share}).
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See id.
the amount of pension costs absorbed by all Government contracts, competitive and noncompetitive, fixed price and cost reimbursement types, and small purchases and major purchases.\(^4\)

Not surprisingly, the 1987 proposal met fierce industry opposition,\(^4\) largely because of the rule’s proposed retroactive effect. The final rule, published August 21, 1989 (and effective September 20, 1989), deleted the 10-year look-back provision and asserted a more limited (i.e., prospective) government right to share in the surplus pension assets.\(^5\) As finally promulgated, the new section 31.205-6(j)(4) provides that:

When excess or surplus assets revert to the contractor as a result of termination of a defined benefit pension plan, or such assets are constructively received by it for any reason, the contractor shall make a refund or give a credit to the Government for its equitable share. The Government’s equitable share shall reflect the Government’s participation in pension costs through those contracts for which certified (see 15.804) cost or pricing data were submitted or which are subject to subpart 31.2.\(^6\)

At the same time, the FAR Credits provision was amended to add a cross-reference to the new section 31.205-6(j)(4). The Termination of Defined Benefit Pension Plans clause was similarly scaled back from the initial proposal, and as finally published, provides that:

The Contractor shall promptly notify the Contracting Officer in writing when it determines that it will terminate a defined benefit pension plan or otherwise recapture such pension fund assets. If pension fund assets revert to the Contractor or are constructively received by it under a termination or otherwise, the Contractor shall make a refund or give a credit to the Government for its equitable share as required by FAR 31.205-6(j)(4). The Contractor shall include the substance of this clause in all subcontracts under this contract which meet the applicability requirement of FAR 15.804(e).\(^7\)

The drafters’ comments explain, without elaboration, that the changes from the initial proposal were made “[a]s a result of public comments re-

\(^4\) Id. at 4085 (proposed FAR 52.215-27).
\(^6\) Id.
ceived."\textsuperscript{53}

Effective August 22, 1991, FAR 31.205-6 was further amended to add a new subparagraph (j)(3)(v), providing that, in absence of an advance agreement, the "withdrawal of assets from a pension fund and transfer to another employee benefit plan fund" would be deemed a constructive withdrawal and receipt of funds under FAR 31.205-6(j)(4).\textsuperscript{54} The new rule required that the advance agreement "(A) State the amount of the Government's equitable share in the gross amount withdrawn; and (B) Provide that the Government receive a credit equal to the amount of the Government's equitable share of the gross withdrawal."\textsuperscript{55} It also mandated that transfers made, without first entering into an agreement, were to be treated as a partial termination of the defined benefit pension plan, requiring a cash refund or credit to the Government.\textsuperscript{56} According to the drafters' comments, this change was necessary to ensure "continuity of the Government's equitable share" in the event a contractor with an overfunded pension plan uses excess pension funds to pay for post-retirement medical benefits (PRB).\textsuperscript{57} Around the same time, a new clause, \textit{Reversion or Adjustment of Plans for Postretirement Benefits Other than Pensions}, was added to the FAR to address reversions of assets from PRB plans.\textsuperscript{58} Like the \textit{Termination of Defined Benefit Pension Plans} clause, the new clause required the contractor to "make a refund or give a credit to the Government for its equitable share" in any PRB fund assets that revert to or are constructively received by the contractor.\textsuperscript{59}

With the promulgation of the revised CAS 413 in 1995, the Government began to assert a right to an "equitable share" in surplus pension funds after a "segment closing," despite the fact that the contractor

\textsuperscript{53} 54 Fed. Reg. at 34,750 (1989).
\textsuperscript{55} Id. at 41,739.
\textsuperscript{56} See id.
\textsuperscript{57} See id. at 41,729. PRB costs include the costs of all postretirement "benefits, other than cash benefits and life insurance benefits paid by pension plans, provided to employees, their beneficiaries, and covered dependent during the period following the employees' retirement." 48 C.F.R. § 31.205-6(o) (1998). Although PRBs may include such benefits as life insurance provided outside of a pension plan, tuition assistance, day care, legal services, and housing subsidies, the single largest PRB cost is due to post-retirement health care. See id.
would not gain access to the funds, either actually or constructively. On March 30, 1995, the CAS Board amended CAS 412 and 413 to "address[] certain problems that have emerged since the original promulgation (in the 1970's) of the pension Standards," including, in particular, "problems associated with overfunded pension plans." Of particular interest here are the changes that were made to CAS 413-50(c)(12) regarding the Government's right to an adjustment as the result of a segment closing. The revision expands the new definition of "segment closing" to include (1) selling or transferring ownership of a segment, (2) discontinuing segment operations, or (3) discontinuing or no longer actively seeking government business under CAS-covered contracts. It also expands coverage of section 413-50(c)(12) to include not only segment closings, but pension plan terminations and curtailments of benefits. Additionally, and perhaps most significantly, the revision adds an aggressive new methodology for determining the "adjustment" due the Government upon the closing of a segment. It requires that, with limited exceptions, the Government's full share—which is to be based on the percentage of CAS-covered contracts—must be credited to the Government in the accounting period of the segment closing event.

More recently, FAR 31.205-6(j)(4) was revised, effective December 29, 1998, to add a complementary "pension adjustment" provision for non-CAS-covered contracts. As amended, FAR 31.205-6(j)(4)(i) provides that for non-CAS-covered contracts and subcontracts, the pension adjustment amount is the amount computed in accordance with CAS 413.50(c)(12)(vi), except that the Government's share is based on the percentage of non-CAS-covered contracts and subcontracts that are subject to the FAR cost principles or for which cost or pricing data were submitted. The revision also provides, at new subparagraph (j)(4)(ii), that for situations other than segment closings, pension plan terminations, or curtailment of benefits, "where assets revert to the contractor, or such assets are constructively received by it for any reason, the contractor shall, at the Government's option, make a refund or give a credit to the Government for its equitable share of the gross amount with-

60. Cf. 48 C.F.R. § 9904.413-50(c)(12).
62. See id. at 16,550.
63. See id. at 16,552.
65. See id. at 58,598.
drawn." Hence, unlike the adjustment required by the revised CAS 413.50(c)(12) and FAR 31.205-6(j)(4)(i), the adjustment required by FAR 31.205-6(j)(4)(ii) does not permit an offset for excise taxes imposed on the withdrawal of pension plan assets.

IV. Government Claims Under CAS 413

A. Computing the "Government's share" Under Revised CAS 413

A wide variety of events can trigger a government claim to surplus pension assets under the revised CAS 413, including (1) contractor sale or other transfer of ownership of a segment, (2) discontinuance of the operations of a segment, (3) discontinuance of the performance or active seeking of CAS-covered government contracts, (4) termination of a pension plan, and (5) curtailment of pension benefits. On the other hand, non-enumerated events, such as pension plan mergers or segment mergers, that do not involve or result in one of the enumerated events, are not segment closing events and do not give rise to a government claim of entitlement. Moreover, the Standard provides that an adjustment is not necessary when the contractor sells or otherwise transfers ownership of a segment and transfers all of the pension plan assets and liabilities allocable to the segment to the successor segment.

It is unclear whether internal reorganizations are segment closing events for purposes of CAS 413.50(c)(12). The CAS Board's comments accompanying the final rule note that "[c]oncerns were raised that an internal reorganization would require a current period adjustment for a segment closing even though neither the segment's nor the contractor's relationship to the Government had changed." The CAS Board responded that:

The definition [of a segment closing] has been revised to delineate three conditions requiring a current period adjustment. The first condition occurs when there is a change in ownership

66. Id. (emphasis added).
67. See Lockheed Martin Tactical Defense Sys., Akron, 98-2 B.C.A. (CCH) ¶ 30,079, at 148,847 (1998). In a decision that could potentially limit the scope of the first segment closing event, i.e., the sale or other transfer of ownership of a segment, the Armed Services Board of Contract Appeals (ASBCA) has recently held that the merger by stock sale of a segment's parent corporation does not change the ownership of the segment. See id. at 148,849-50 (1998).
69. See id. § 9904.413-50(c)(12)(v).
of the segment, not just a simple reorganization within the contractor’s internal structure. The second event is the one addressed in the NPRM; that is, when the contractual relationship ends because the segment operationally ceases to exist. The third case addresses the end of the contractual relationship with the Government, whether the segment continues in operation or not. 71

Two points are worth noting. First, the CAS Board’s assurance that “just a simple reorganization” is not a segment closing addresses only one of the segment closing events. Second, and perhaps more troublesome, the two illustrations involving internal reorganizations both conclude that a segment closing has occurred. The illustration at CAS 413-60(c)(13) involves a contractor who, as part of a corporate reorganization, closes the production facility for one of its segments and transfers all of the segment’s contracts and employees to its two remaining government segments. 72 The illustration concludes that a segment closing has occurred because the segment has discontinued operations. 73 Nevertheless, it goes on to note that “because all pension assets and liabilities have been transferred to other segments or to successors in interest of the contracts of [the closed segment], an immediate period adjustment is not required pursuant to 9904.413-50(c)(12)(v).” 74 The illustration at CAS 413-60(c)(14) involves a contractor who decides to exit the government market, reducing the workforce of its government segment and converting its operations to commercial work. 75 Again, the illustration concludes that a segment closing has occurred. Moreover, it asserts that a segment closing adjustment is required. 76

Upon the occurrence of any of the enumerated segment closing events, the contractor is required to perform a final segment accounting by computing, as of the date of the event, “the difference between the actuarial accrued liability for the segment and the market value of the assets allocated to the segment.” 77 In determining the actuarial accrued liability for the segment, the contractor is required to use the accrued benefit cost method 78 and actuarial assumptions that are “consistent with the current

71. Id.
73. See id.
74. Id.
75. See id. § 9904.413-60(c)(14).
76. See id.
77. Id. § 9904.413-50(c)(12).
and prior long term assumptions used in the measurement of pension costs” on the contractor’s government contracts.79 Nevertheless, if the contractor terminates its pension plan, the actuarial accrued liability is measured by the amount paid to settle its benefit obligations, e.g., the amount paid to purchase annuities for its employees or paid to the Pension Benefit Guarantee Corporation.80 Improvements to a pension plan adopted within sixty months prior to the segment closing, except those mandated by law or collective bargaining agreement, are recognized only on a pro-rata phase-in basis.81 For example, the computation of actuarial accrued liabilities would include only fifty percent (i.e., 30/60) of the added cost of a benefit implemented thirty months before the segment closing. “[T]he difference between the actuarial accrued liability for the segment and the market value of the assets allocated to the segment” is called the “adjustment amount.”82 The adjustment amount is to be reduced by any excise tax imposed on the contractor for withdrawing the pension assets.83

The “Government’s share” under the revised CAS 413 is computed by multiplying the net adjustment amount by a fraction: the numerator is “the sum of the pension plan costs allocated to all [CAS-covered] contracts and subcontracts (including Foreign Military Sales) . . . during a period of years representative of the Government’s participation in the pension plan”84 (a term that is not defined), and the denominator is the total pension costs assigned during the same “representative” period of years.85 In other words, the Government’s purported “equitable share” is based upon the segment’s percentage of CAS-covered prime contracts and subcontracts during a period of years in which the Government was

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80. See id.
81. See id. § 9904.413-50(c)(12)(iv).
82. Id. § 9904.413-50(c)(12).
83. See id. § 9904.413-50(c)(12)(vi).
84. Id., but cf. infra note 86 and accompanying text (noting that the period of years should include the whole life of the plan).
85. See 48 C.F.R. § 9904.413-50(c)(12)(vi) (1998). Mathematically, the equation for computing the Government’s share is as follows:

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\frac{\text{aggregate amount of pension costs allocated to all CAS-covered contracts and subcontracts during a representative period of years}}{\text{total pension costs assigned during the same representative period of years}} \times (\text{surplus} - (\text{minus}) \text{excise taxes}) = \text{government share}. \]

See id.
"participating" in the pension plan, without regard to whether those contracts were firm-fixed-price or flexibly priced, whether the contracts are now open or closed, or whether the surplus was built up over many years before the contractor ever held a CAS-covered contract. Significantly, the adjustment, which could be made on one or several CAS-covered contracts, would not be limited to the amounts allocated to the Government. Rather, the Government’s claim would include the unrealized appreciation (i.e., investment growth to date) of such costs. In other words, the Government would seek its share of the pension plan’s investment earnings, notwithstanding the fact that all of the pension assets would remain in the pension trust. Moreover, the full amount of the Government’s supposed share is due “as a credit or charge during the cost accounting period in which the event occurred and contract prices/costs will be adjusted accordingly.” The parties may, however, decide upon an amortization schedule, with interest, if the contractor continues to perform government contracts.

B. The Revised CAS 413 Changes, Not Clarifies, the Original Standard

By its terms, the revised Standard becomes applicable upon receipt of a CAS-covered contract or subcontract in the contractor’s first fiscal year after March 30, 1995. Nonetheless, and in spite of the obvious significance of the March 1995 revisions, paragraph 9904.413-64(c) of the revised Standard asserts that: “[T]his Standard . . . clarifies, but is not intended to create, rights of the contracting parties, and specifies techniques for determining adjustments pursuant to 9904.413-50(c)(12). These rights and techniques should be used to resolve outstanding issues that will affect pension costs of contracts subject to this Standard.”

One of the principal drafters of the CAS 413 revisions, Health Care Financing Administration employee Eric H. Shipley, testified in a deposition that he had carefully chosen the wording of this paragraph:

I have been coached enough by enough lawyers that the word choice – one of the pivotal words in this paragraph is – that I used “should” instead of the mandatory “shall.” The intent –

86. See id. More equitably, the period of years pinpointed as the Government’s participation in the pension plan should include the entire life of the plan because the plan assets and liabilities necessarily accumulate over many years, and not just during the period in which the contractor’s contributions happen to be allocated to its CAS-covered government contracts.
87. Id. § 9904.413-50(c)(12)(vii).
88. See id.
89. See 48 C.F.R. § 9904.413-63(a), (b) (1998).
90. Id. § 9904.413-64(c).
and what – the reason the board accepted and approved this paragraph was they agreed with the notion that the new CAS certainly characterized how they saw the CAS should have been operating and took care of a lot of things by specificity, and they wanted to make sure that it was strongly regarded as authoritative guidance.91

The case in which this testimony was provided, Gould, Inc.,92 involved a government claim for surplus pension assets arising out of the contractor’s sale of five business units during 1987 and 1988. The case was pending before the Armed Services Board of Contract Appeals (ASBCA) when the revised CAS 413 was published.93 The Government urged the ASBCA to apply the revised provisions of CAS 413, arguing that the revision was “only a clarification rather than a substantive change.”94 Not surprisingly, the ASBCA rejected the Government’s argument, holding that:

We believe that we should hearken to the language and administrative history of the original standard as in effect at the relevant time. If the references to “prices” in the standard as amended have the effect urged by the Government, a question which we do not decide, it is quite clear that they go beyond anything in [CAS 413.50](c)(12) as applicable to this appeal.95

The ASBCA also held that CAS 413, as originally promulgated, did not entitle the Government to recover any share of surplus pension assets allocable to firm-fixed-price contracts, but required a current period adjustment of pension costs allocable to flexibly priced contracts.96 Expressly left unresolved in Gould is the validity and reach of the new CAS 413.

C. Potential Legal Challenges to Government Claims Under the Revised CAS 413

The Government faces significant, and perhaps insurmountable hurdles in seeking to enforce the terms of the revised CAS 413, because the Standard is flawed both procedurally and substantively. The revised

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93. See id.
96. See id.
Standard is procedurally defective because in promulgating the revision the CAS Board failed to comply with the rulemaking requirements of the Office of Federal Procurement Policy (OFPP) Act. The revision is also substantively flawed because it exceeds the CAS Board's statutory authority. Finally, even if the revised CAS 413 were deemed applicable and enforceable, the contractor would nonetheless be entitled to an offsetting equitable adjustment in the amount of the Government's demand.

1. The CAS Board Failed to Follow the Required Rulemaking Procedures

As an independent board within OFPP, the CAS Board is subject to the rulemaking provisions of the OFPP Act. Absent urgent and compelling circumstances, Section 22 of the OFPP Act prohibits any procurement regulation having either "a significant effect beyond the internal operating procedures of the agency" or "a significant cost or administrative impact on contractors" from taking effect until sixty days after the regulation is published for public comment. Additionally, Section 26(g) requires completion of a careful four-step rulemaking process before the CAS Board may issue any new or revised Standard. Under the four-step process, the Board first must study the issue in consultation with the Comptroller General, professional accounting organizations, contractors, and other interested parties, and publish the results of this study in the Federal Register. Second, the Board must "publish an advanced notice of proposed rulemaking [(ANPRM)] in the Federal Register," and allow sixty days for public comment. Third, after consideration of the comments received, the Board must publish a notice of proposed rulemaking (NPRM), and allow at least sixty additional days for public comment. Fourth, after again considering the comments received, the Board may publish a final rule. Although the Board may properly modify a proposed rule in response to public comments without the necessity of further comment, it cannot introduce significant, substantive changes without providing the requisite notice and public com-

98. See id. § 418b(a).
99. See id. § 422(g).
100. See id. § 422(g)(1)(A), (B).
101. Id. § 422(g)(1)(C).
102. See id. § 422(g)(1)(D).
103. See id. at § 422(g)(2).
The CAS Board has violated these procedural requirements by making significant changes to CAS 413 after the NPRM and therefore without benefit of public comment. Indeed, the CAS Board itself has conceded as much in its comments accompanying publication of the final rule, explaining that:

The public comments received in response to the NPRM raised some new issues. In the final rule, the Board addresses these issues focusing on three areas in particular. These deal with the restriction of accrual accounting by an outside limit, incomplete and unclear coverage for segment closings and pension plan terminations, and the lack of accounting for differences between accrued and funded pension costs.\(^{105}\)

The ANPRM deals principally with CAS 412,\(^ {106}\) and the NPRM, although it discusses CAS 413, makes only modest changes to the original CAS 413.\(^ {107}\) The Board added all of the most controversial aspects of the new segment closing provision, § 9904.413-50(c)(12)(i) through (vii), after publishing the NPRM, and thus promulgated them without the requisite public notice and comment.\(^ {108}\) Most significantly, the final rule, unlike the NPRM, requires a current period adjustment regardless of whether pension assets have actually reverted to the contractor, and includes in the calculation of that adjustment closed and FFP contracts.\(^ {109}\) By contrast, the NPRM makes comparatively minor changes to the original CAS 413.50(c)(12): other than distinguishing between qualified and nonqualified plans, the NPRM repeats, verbatim and without elaboration, the original CAS 413.50(c)(12) statement that "the difference between the market value of the assets and the actuarial liability for the segment represents an adjustment of previously-determined pension costs."\(^ {110}\) Additionally, the final rule revises the definition of segment

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104. See infra notes 122, 125 and accompanying text (discussing cases that have addressed what qualifies as significant substantive changes).
108. See supra note 105 and accompanying text (explaining that the final rule reflects changes made, in response to NPRM comments, without such changes first being subject to public scrutiny).
closing "to delineate three conditions requiring a current period adjustment";111 the NPRM only addresses one of these conditions, namely, sale or other transfer of ownership.112 The final rule also adds a sixty-month phase-in for benefit improvements that is not mentioned in the NPRM.113 Finally, whereas the ANPRM observes that "pension costs estimated for fixed price contracts are never adjusted regardless of subsequent actuarial events,"114 the final rule asserts a right to adjust the price of fixed-price contracts.115 These changes are not only significant, but they were made without any notice, in either the ANPRM or the NPRM.116

The functions the CAS Board exercises are exempt from review under the Administrative Procedures Act,117 but are reviewable under the

112. Compare id. at 16,550 (defining segment closing as when “a segment has (i) been sold or ownership has been otherwise transferred, (ii) discontinued operations, or (iii) discontinued doing or actively seeking Government business under contracts subject to this Standard”), with Notice of Proposed Rulemaking, 58 Fed. Reg. at 59,005 (defining segment closing as when “a segment has been sold, abandoned, spun off, or otherwise disposed of.”).
   (Pension plan improvements adopted within 60 months of the date of the [segment closing] event which increase the actuarial accrued liability shall be recognized on a prorata basis using the number of months the date of adoption preceded the event date. Plan improvements mandated by law or collective bargaining agreement are not subject to this phase-in.),
with Cost Accounting Standards for Composition, Measurement, Adjustment, and Allocation of Pension Costs, 58 Fed. Reg. at 59,005-06 (NPRM contains no provision comparable to § 9904.412-50(c)(12)(iv)).
116. See supra note 105 and accompanying text (illustrating that the final rule reflects changes made without public notice). Ironically, it was only after making significant changes in the final rule that the CAS Board added language to § 9904.413-64(c) to claim that the revised Standard merely "clarifies" the existing rule. See Cost Accounting Standards for Composition, Measurement, Adjustment, and Allocation of Pension Costs, 60 Fed. Reg. at 16,557.
117. See 41 U.S.C. § 422(g)(3). The Administrative Procedures Act is found at Title 5, Chapter 5 of the U.S.C. Specifically, 5 U.S.C. §§ 551, 553-59 are not applicable to CAS Board actions. See id.
Government Claims to Surplus Pension Assets

Contract Disputes Act\textsuperscript{118} and the Tucker Act.\textsuperscript{119} Although there are no reported decisions that challenge the Standards issued by the current CAS Board based on procedural deficiencies, several contractors have challenged Standards promulgated by the previous CAS Board on this basis.\textsuperscript{120} Although applicable law and regulation did not require the previous CAS Board to comply with precisely the same procedural requirements as the current CAS Board,\textsuperscript{121} these challenges are nevertheless instructive.

For example, in \textit{Lockheed Corp.},\textsuperscript{122} the ASBCA found unenforceable the CAS Board Interpretation No. 1 to CAS 403 because the CAS Board “failed to follow the statutory requirements for issuance of a standard.”\textsuperscript{123} The ASBCA rejected the Government’s argument that the interpretation effected only a “minor” or “technical” change, which would not require notice and comment; it reasoned that a new definition of “factors” for CAS 403 was not a “trivial” matter.\textsuperscript{124} On the other hand, in \textit{Boeing Co. v. United States},\textsuperscript{125} the Court of Claims, now called the United States Court of Federal Claims, concluded that CAS 403 was properly promulgated, because the final rule was, with the exception of a minor change to one of the illustrations, substantially the same as the proposed rule.\textsuperscript{126} Hence, where the final rule contains significant, substantive changes that were not made available for public comment, as was the case with CAS 413.50(c)(12), the new or modified Standard should be held invalid and

\begin{footnotesize}
\begin{enumerate}
\item[119.] See 28 U.S.C. § 1491(a) (1994).
\item[121.] Compare § 103, 84 Stat. at 798-99, with § 26, 102 Stat. at 4061.
\item[122.] 86-1 B.C.A. (CCH) at 93,513.
\item[123.] Id. at 93,542.
\item[124.] See id. at 93,541.
\item[125.] 680 F.2d 132 (Ct. Cl. 1982).
\item[126.] See id. at 140.
\end{enumerate}
\end{footnotesize}
unenforceable. 127

2. The Revision Exceeds the CAS Board’s Statutory Authority

Even if the CAS Board were to correct these procedural deficiencies, by republishing the revision after the requisite notice and public comment, the Standard would likely still be unenforceable because it exceeds the CAS Board’s statutory authority. Regulations have the force and effect of law only when they are promulgated pursuant to a statutory grant of authority. 128 Congress has expressly limited the authority of the current CAS Board, as it did the authority of the original Board, to matters of cost allocability, and not allowability. 129 As the Senate Report explains:

In considering the functions and responsibilities of the Board, the Committee concluded that the agencies, rather than the Board, should be responsible for determining the allowability of specific costs. In his testimony on S. 2215, the Comptroller General stated, "We believe it is important to separate the cost allocability standards and the cost allowability principles. Allocability is an accounting issue and allowability is a procurement policy issue."

The Committee agrees with this distinction. Accordingly, Section 4 assigns only allocability functions to the Board. Allowability and other similar policy issues will be addressed by the Administrator and the agencies outside the purview of the CAS Board.130

The Office of Federal Procurement Policy (OFPP) Act Amendments of 1988 specifically authorize the CAS Board to promulgate cost accounting standards for the measurement, assignment, and allocation of costs, to be used in estimating, accumulating, and reporting those costs.131 Furthermore, it is authorized to promulgate regulations requiring contractors to agree to contract price adjustments to protect the Government from the payment of increased costs as a result of the contractors’ failure to comply with disclosed and established cost accounting prac-

127. See supra Part IV.C.1 (analyzing the author’s position).
128. See Chrysler Corp. v. Brown, 441 U.S. 281, 304, 308 (1979); see also Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988) (“It is axiomatic that an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress.”).
130. Id.
tices, applicable standards, or as a result of their voluntary accounting changes. The so-called “segment closing” provision of the new CAS 413 goes well beyond this statutory authorization. It is neither a “cost accounting standard” nor a regulation designed to recover “increased costs” the United States has paid.

Unlike a cost accounting standard, the new segment closing adjustment provision of CAS 413.50(c)(12) does not regulate the measurement, assignment, or allocation of pension costs. In fact, the new provision has nothing to do with costs. At least in those circumstances where surplus pension assets have resulted from unanticipated earnings growth or other increases in asset value, the segment closing provision has to do with the calculation and recapture of income attributable to previously allocated pension costs. In essence, the new segment closing adjustment provision creates an omnipotent, CAS-version of the FAR Credits provision that purports to require contract cost and price adjustments to “credit” the Government with its “equitable share” of the income earned on pension plan assets.

The new segment closing provision also exceeds the authority granted by 41 U.S.C. § 422(h) because it requires a contract adjustment in the absence of any noncompliance with applicable Standards or change in accounting practices. A “cost accounting practice” is defined as “any disclosed or established accounting method or technique which is used for allocation of cost to cost objectives, assignment of cost to cost accounting periods, or measurement of cost.” A “change to a cost accounting practice” is defined as “any alteration in a cost accounting practice,” other than the “initial adoption of a cost accounting practice” or “partial or total elimination of a cost or the cost of a function.” The accounting associated with a segment closing is not a change to a cost accounting practice. Indeed, the CAS Board’s illustrations of changes that do not meet the definition of a change to a cost accounting practice expressly provide that the elimination of a segment is not a cost accounting practice change.

133. Where there is a shortfall of assets in relation to liabilities (for whatever reason), and the Government must, therefore, make up its share of the shortfall, this exercise likewise has nothing to do with the measurement, assignment, or allocation of costs.
135. Id. § 9903.302-1.
136. Id. § 9903.302-2.
137. See id.
138. See id. § 9903.302-4(e). The illustration is as follows:
   Description: A contractor eliminates a segment that was operated for the pur-
Nor would any government claim under the new CAS 413 be seeking “increased costs” paid as that term is currently defined. Consistent with the underlying Congressional objectives, the CAS Board has interpreted the term “increased costs paid” as follows:

(a) Increased costs [paid] shall be deemed to have resulted whenever the cost paid by the Government results from a change in a contractor’s cost accounting practices or from failure to comply with applicable Cost Accounting Standards, and such cost is higher than it would have been had the practices not been changed or applicable Cost Accounting Standards complied with.

(b) If the contractor under any fixed-price contract, including a firm fixed-price contract, fails during contract performance to follow its cost accounting practices or to comply with applicable Cost Accounting Standards, increased costs are measured by the difference between the contract price agreed to and the contract price that would have been agreed to had the contractor proposed in accordance with the cost accounting practices used during contract performance. The determination of the contract price that would have been agreed to will be left to the contracting parties and will depend on the circumstances of each case.

Under the new segment closing provision of CAS 413, however, a contract adjustment is required even though the contractor has fully complied with all applicable Standards and its disclosed and established cost accounting practices, and has consistently estimated and accumulated its pension costs in accordance with those practices. Hence, the adjustment is unrelated to the statutory concept of “increased costs” paid and is, therefore, not authorized by the statute.

Nor does the Cost Accounting Standards clause authorize the CAS 413-50(c)(12) adjustment. That clause requires the contractor to, inter alia, (1) “[a]gree to an equitable adjustment . . . if the contract cost is affected by a [mandatory or mutually agreed-to] change” to the contrac-

Id.
139. See id. § 9903.306(a).
140. Id. § 9903.306(a), (b).
141. See id. § 9904.413-50(c)(12).
142. See id. § 52.230-2.
tor’s cost accounting practices, and (2) “[a]gree to an adjustment of the contract price or cost allowance, as appropriate, if the Contractor or a subcontractor fails to comply with an applicable Cost Accounting Standard, or to follow any cost accounting practice consistently and such failure results in any increased costs paid by the United States.” A segment closing event is not a CAS noncompliance, a failure to follow consistently a cost accounting practice, or a change to an accounting practice. Hence, there is no provision under the Cost Accounting Standards clause that permits the adjustment of contract prices.

The CAS Board also lacks statutory authority to apply the revised Standard retroactively or retrospectively. In promulgating the revisions to CAS 413, the CAS Board explained that “[a]ll adjustments shall be prospective only,” but that “costs/prices of prior and existing contracts not subject to price adjustment may be considered in determining the appropriate . . . adjustment amount for the computation of costs/prices of contracts subject to this Standard.” Notwithstanding these double-speak assurances, the revised CAS 413, although perhaps not explicitly retroactive, is nonetheless quite plainly “retrospective.” Justice Story explained the distinction between retroactive and retrospective almost two centuries ago: an explicitly retroactive rule is one “enacted to take effect from a time anterior to [its] passage;” a retrospective rule is one “which takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past.” Applying the revised CAS 413 to segment sales that have occurred before its applicability date would therefore be “retroactive”; using contracts awarded prior to March 30, 1995 to calculate the amount of the Government’s “equitable share” would be “retrospective.” Nevertheless, the terms are synonymous, and whether called retroactive or retrospective, the result and legal analysis are the same.

In essence, the revised CAS 413 uses the pretext of “adjusting” the price or cost allowance of current contracts to reprice previous contracts retroactively. Indeed, CAS 413-50(c)(12) expressly acknowledges that

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143. Id. § 52.230-2(a)(4), (5).
146. Wheeler, 22 F. Cas. 756 at 767; see also Landgraf, 511 U.S. 244 at 269.
147. See Landgraf, 511 U.S. at 269 n.23 (quoting 2 N. SINGER, SUTHERLAND ON STATUTORY CONSTRUCTION § 41.01, at 337 (5th ed. 1993)).
the required adjustment "represents an adjustment of previously-determined pension costs." The following example demonstrates the Standard's retroactivity: assume a contractor has performed a significant amount of government business over a period of thirty years, and during that time maintained a defined benefit pension plan for its employees. Assume further (1) that the plan became overfunded in 1987; (2) until that time, the pension costs allocated to government contracts accounted for approximately ninety percent of the total contributions made; and (3) the accumulated surplus now amounts to approximately $200 million. Finally, assume that since 1987, the contractor's CAS-covered business has steadily declined, and it now has a single, $500,000 CAS-covered contract. Because the contractor is no longer actively seeking CAS-covered contracts, the Government determines that a "segment closing" has occurred under the revised CAS 413, and makes a demand in the amount of $180 million for its equitable share of the accumulated surplus. Accordingly, the "adjusted" price of the contractor's sole remaining CAS-covered contract is negative $179,500,000. Clearly the adjustment has nothing to do with the current contract—it is a "recovery" of the income earned on costs allocated to earlier contracts. Thus, the CAS Board is simply wrong: the revision is retroactive, and therefore exceeds its statutory authority.

As the Supreme Court recently confirmed in Hughes Aircraft Co. v. United States ex rel. Schumer, "there is a 'presumption against retroactive legislation [that] is deeply rooted in our jurisprudence,'" and statutes and regulations "will [only] be construed to have retroactive effect [if] their language [expressly] requires this result." This is a long-

148. 48 C.F.R. § 9904.413-50(c)(12) (emphasis added).
149. The government claim is computed by multiplying the ratio of pension costs allocated to CAS-covered contracts and subcontracts to total pension costs assigned (.90) by the net surplus ($200 million): .90 x $200,000,000 = $180,000,000.
150. Cf. Teledyne Continental Motors (Gen. Prods. Div.) 85-3 B.C.A. (CCH) ¶ 18,472, at 92,785 (1985) (explaining that an accounting change could not be considered "prospective" within the meaning of the CAS clause where it would be "applied to an existing contract, affecting its cost or price whenever the same is finally determined"). The revised CAS 413 is even more clearly retroactive than the accounting change at issue in Teledyne Continental Motors, because it not only contemplates application to existing contracts, but effectively seeks to "adjust" the costs of prior contracts. See 48 C.F.R. § 9904.413-50(c)(12).
152. Id. at 946 (quoting Landgraf, 511 U.S. at 265).
standing principle, and the presumption against retroactivity is particularly compelling in the aforementioned contractor situation because it upsets the party’s contractual rights. As the Court in Landgraf v. USI Film Products explained:

Since the early days of this Court, we have declined to give retroactive effect to statutes burdening private rights unless Congress had made clear its intent . . . . The largest category of cases in which we have applied the presumption against statutory retroactivity has involved new provisions affecting contractual or property rights, matters in which predictability and stability are of prime importance.

In Bowen v. Georgetown University Hospital, the Supreme Court applied this well-settled principle to strike down retroactive cost-reimbursement regulations the Secretary of Health and Human Services had promulgated, holding that “a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms.” As was true in Bowen, the statute underlying CAS 413 does not expressly require retroactivity. Quite the contrary, the OFPP Act does not even permit retroactive regulations. The Act provides, in pertinent part, that all of the Standards the original CAS Board promulgated “shall remain in effect unless and until amended, superseded, or rescinded by the Board pursuant to this section.” The Act further provides that promulgations of the new CAS Board “shall become effective within 120 days after publication in the Federal Register.” Read together, these sections prohibit the CAS Board from retroactively changing any of the original CAS Board’s standards, including CAS 413. Thus, the Act certainly cannot be said to evidence clear and emphatic congressional intent that standards and regulations promulgated pursuant to the Act be applied retroactively.

154. See, e.g., Brimstone R.R. & Canal Co. v. United States, 276 U.S. 104, 122 (1928) (“The power to require readjustments for the past is drastic. It . . . ought not to be extended so as to permit unreasonably harsh action without very plain words.”).
155. 511 U.S. at 244 (1994).
156. Id. at 270-71 (footnote omitted).
158. Id. at 208, 215.
160. Id. § 422(j)(1) (emphasis added).
161. Id. § 422(g)(2) (emphasis added).
162. Cf. Landgraf v. USI Film Prods., 511 U.S. 244, 270 (1994) (requiring clear congressional intent indicating that a statute is to be applied retroactively before a court will “give retroactive effect to statutes”).
Retroactive application of the revised CAS 413 would also effect an unconstitutional taking of private property without just compensation in violation of the Fifth Amendment.\textsuperscript{163} Although Congress has broad legislative authority, the Supreme Court has long recognized that the Fifth Amendment limits Congress from using that authority to take away the vested contractual rights of government contractors.\textsuperscript{164} When the Government deprives a contractor of its vested contractual rights, the Fifth Amendment requires that the government make “just compensation.”\textsuperscript{165} Thus, for example, when the United States took possession of ship hulls and related work-in-process from a defaulting contractor, thereby rendering unenforceable and worthless the contractor’s materialmen’s liens in the incomplete ships, the Supreme Court required the Government to compensate the contractor for the value of the property taken.\textsuperscript{166}

Although applying a more traditional breach of contract analysis,\textsuperscript{167} the Court of Appeals for the Federal Circuit and Supreme Court decisions in \textit{Winstar Corp. v. United States}\textsuperscript{168} confirm that the Government cannot abrogate a contractor’s vested contractual rights without paying just com-

\footnotesize{\textsuperscript{163} See U.S. CONST. amend. V.  
\textsuperscript{164} See Sinking-Fund Cases, 99 U.S. 700, 720-21 (1878) (recognizing that legislative authority cannot be used “to take away property already acquired under the operation of the charter, or to deprive the corporation of the fruits actually reduced to possession of contracts lawfully made,” nor to “unmake contracts that have already been made”); see also Perry v. United States, 294 U.S. 330, 351 (1935): To say that the Congress may withdraw or ignore [its] pledge, is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the pleasure and convenience of the pledgor. This Court has given no sanction to such a conception of the obligations of our Government. Id. See also Lynch v. United States, 292 U.S. 571, 580 (1934) (“Congress [is] without power to reduce expenditures by abrogating contractual obligations of the United States. To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an act of repudiation.”).  
\textsuperscript{165} See Armstrong v. United States, 364 U.S. 40, 49 (1960) (asserting that the Government’s taking of private property is a constitutional provision entitling lienholders to just-compensation under the Fifth Amendment).  
\textsuperscript{166} See id. at 46-49 (holding that despite the Government’s sovereign immunity, its taking of private property requires compensation).  
\textsuperscript{167} Notably, the Claims Court, now the Court of Federal Claims, has expressed a preference for avoiding constitutional issues if possible. See Hughes Communications Galaxy, Inc. v. United States, 26 Cl. Ct. 123, 145 n.24 (1992), \textit{rev’d on other grounds}, 998 F.2d 953 (Fed. Cir. 1993) (“While it is clear that contracts rights are property for purposes of the takings clause, that clause is rarely used if the case can be adequately resolved using a contract analysis.”) Moreover, unlike the Court of Federal Claims, the ASBCA has held that it has no jurisdiction to grant relief based on the Constitution. See United Techs. Corp., 95-1 B.C.A. (CCH) ¶ 27,456, at 136,770 (1995).  
\textsuperscript{168} 64 F.3d 1531 (Fed. Cir. 1995) \textit{(en banc)} (holding that the Government’s taking of contract rights requires just compensation), \textit{aff’d}, 518 U.S. 839 (1996).}
pensation. That case involved a number of failing thrifts, which, during the savings and loan crisis of the early 1980’s, were merged with healthy thrifts to relieve insurance claims on the Federal Savings and Loan Insurance Corporation (FSLIC). The FSLIC and Bank Board agreed that the newly-formed thrifts could treat the “supervisory goodwill” resulting from the mergers as satisfying part of their regulatory capital requirements.\textsuperscript{169} Congress subsequently enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA),\textsuperscript{170} which required the newly created Office of Thrift Supervision (OTS) to “prescribe and maintain uniformly applicable capital standards for savings associations,” and prohibited the continued use of supervisory goodwill to satisfy regulatory capital requirements.\textsuperscript{171} The plaintiff thrifts filed suit in the Court of Federal Claims, arguing that the “government was contractually obligated to recognize supervisory goodwill generated by the mergers,” and that FIRREA therefore constituted a breach of contract or, alternatively, “a taking of their contract rights without compensation in violation of the Fifth Amendment.”\textsuperscript{172} The Court of Federal Claims agreed that the Government breached its contracts with the plaintiffs and the United States appealed to the Federal Circuit.\textsuperscript{173} In its en banc decision, the Federal Circuit concluded that the Government was contractually obligated to recognize supervisory goodwill, and that through FIRREA and its regulations, the Government did not execute its contractual obligations.\textsuperscript{174} The court rejected the Government’s argument that Congress’s sovereign power to regulate would be impaired by compelling the Government “to pay for the results of its actions.”\textsuperscript{175} As the court explained, “[m]oney damages, in contrast to injunctive relief, presents little threat to the government’s sovereign powers, other than the obvious financial incentive to honor its contracts.”\textsuperscript{176} Furthermore, the court concluded that the FIRREA was not a “sovereign act” because its “principal effect [was] to abrogate specific contractual rights,” and the Government therefore was “not immunize[d] . . . from contrac-

\textsuperscript{169} See id. at 1535 (noting the FSLIC’s desire that the healthy and failing thrifts merge to prevent liquidation of the failing thrifts and to protect its own insurance funds).


\textsuperscript{172} Winstar Corp., 64 F.3d at 1539.

\textsuperscript{173} See id. The Court, however, did not consider the plaintiffs’ constitutional takings argument.

\textsuperscript{174} See id. at 1545.

\textsuperscript{175} Id. at 1547 (quoting Winstar Corp. v. United States, 21 Cl. Ct. 112, 116 (1990)).

\textsuperscript{176} Id. at 1547-48.
The Supreme Court affirmed, agreeing with the Federal Circuit "that 'the government was contractually obligated to recognize the capital credits and the supervisory goodwill generated by the merger as part of the [thrift's] regulatory capital requirement,'" and that because the Government breached its agreement, it was "liable in damages for breach." 

Just as Congress is precluded from abrogating the contractual rights of government contractors without paying just compensation, so, too, is the CAS Board acting under a Congressional grant of authority. Thus, even if the CAS Board had the requisite statutory authority to promulgate its revised CAS 413, the Fifth Amendment precludes it from applying that authority in abrogation of the Government's contractual obligations.

Wholly apart from the clear statutory, contractual, and Constitutional prohibitions on its retroactive application, there are also compelling reasons of equity that prevent giving the revised CAS 413 retroactive effect. Both the Court of Federal Claims and ASBCA have long held that the Government is estopped from retroactively disallowing costs, or retroactively disapproving a contractor's cost accounting practices, when a contractor has detrimentally relied on the Government's acquiescence or approval of those costs and accounting practices.

177. Id. at 1548-49.
179. See American Elec. Labs., Inc. v. United States, 774 F.2d 1110, 1113 (Fed. Cir. 1985) (stating that “[t]he Government in certain situations may be estopped from denying actions relied on by others to their detriment, where such action is within the scope of its agent’s authority.”)(citing Breed Corp. v. United States, 27 Cont. Cas. Fed. (CCH) ¶ 80,333, at 85,453 (Ct. Cl. Apr. 4, 1980)); Broad Ave. Laundry & Tailoring v. United States, 681 F.2d 746, 748-49 (Ct. Cl. 1982) (holding that the government is estopped from disallowing costs where the contractor relied to its detriment on wage determination erroneously included in the contract); see also Emeco Indus., Inc. v. United States, 485 F.2d 652, 657 (Ct. Cl. 1973) (noting that “a party who engages in a course of conduct, even without misrepresentation, upon which another party has a right to believe he is intended to act or upon which the first party intended him to act, will be estopped from repudiating the effect of such conduct.”); Litton Sys., Inc. v. United States, 449 F.2d 392, 401 (Ct. Cl. 1971) (concluding that “In view of plaintiff's long and consistent use of the cost of sales method with the Government's knowledge, approval and acquiescence, plaintiff was entitled to reasonably adequate notice that the Government would no longer approve the use of that method with respect to the CPFF contracts.”); PACCAR, Inc., 89-2 B.C.A. (CCH) ¶ 21,696, at 109,080 (1989) (acknowledging that the courts “have been reluctant to permit either party to benefit from retroactive accounting changes, ... and have taken note of the ‘commercial havoc’ that could result by permitting the practice in the absence of ‘peculiar’ circumstances”); Gould Defense Sys., Inc., 83-2 B.C.A. (CCH) ¶ 16,676, at 82,981, 82,984 (1983) (holding that the Government was estopped from retroactively disallowing the cost of goodwill); Data-Design Labs., 81-2 B.C.A. (CCH) ¶ 15,190, at 75,172 (1981) (refusing to permit the Government to disallow retroactively the cost of first-class air fare); Penin-
3. The Cost Accounting Standards Clause Entitles the Contractor to an Equitable Adjustment in the Full Amount of the Government's Claim

Moreover, even if the revised CAS 413 were valid and enforceable, the Cost Accounting Standards clause would entitle the contractor to an equitable adjustment in the full amount of the Government's claim. Subparagraph (a)(3) of the clause requires the contractor to comply with all CAS "in effect on the date of [contract award]," and to apply prospectively any changes in its cost accounting practices that are necessary to comply with a new or modified CAS. In exchange, the clause gives the contractor the right to an equitable adjustment under the Changes clause if the contract cost is affected by a change that the contractor is required to make to comply with a new or modified Standard. As discussed above, the March 1995 revisions to CAS 413 are much more than mere clarifications, and represent a mandatory change under paragraph (a)(3) of the CAS clause. To the extent that this newly defined "adjustment" exceeds the amount for which the contractor would have been liable under the original CAS 413, it represents a change for which the contractor is entitled to an equitable adjustment under subparagraph (a)(4)(i) of the CAS clause.

The term "equitable adjustment" is a term of art, and is measured by the cost impact on the contractor. As the former Court of Claims ex-
plained in *Bruce Construction Corp. v. United States*, equitable adjustments under the *Changes* clause "are simply corrective measures utilized to keep a contractor whole," and the measure of damages, therefore, is "closely related to and contingent upon the altered position in which the contractor finds himself by reason of the modification." Moreover, even if the change does not cause the contractor to incur increased costs, where the Government deprives the contractor of something of value, the ASBCA has found the contractor entitled to the value of the asset taken.

The same equitable adjustment principles apply when the dispute involves accounting changes. For example, in *Ford Aerospace & Communications Corp.*, the Government directed Ford to change its allocation of general and administrative (G&A) costs from a value-added cost input base to a total cost input base in order to comply with the newly promulgated CAS 410. As a result of making the change, Ford recovered substantially less G&A costs than it had anticipated it would in estimating and pricing a large fixed-price contract. The ASBCA concluded that Ford's value-added cost input base was in compliance with CAS 410, and the government-directed accounting change amounted to a constructive change to the contract. The Board, therefore, held that Ford was entitled to an equitable adjustment, measured pursuant to the parties' stipulation - by the amount the contract was underpriced.

Because the CAS clause expressly provides for an equitable adjustment under the *Changes* clause, the amount of the equitable adjustment is the same whether measured under the CAS clause or the *Changes* clause. Accordingly, the measure of the equitable adjustment to which the contractor is entitled would be the amount by which the "adjustment" required under the revised CAS 413 exceeds the amount for which the contractor would have been liable under the original CAS 413; that is, the amount by which the change has increased the contractor's

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187. 324 F.2d 516 (Ct. Cl. 1963).
188. *Id.* at 518 (holding that the purpose of equitable adjustments is to protect the contractor against increased costs resulting from contract modification).
189. *See Norcoast Constructors, Inc. 72-2 B.C.A. (CCH) ¶ 9699, at 45,284-85 (1972)* (concluding that in a dispute over ownership of fuel storage tanks used during contract performance, the contractor was entitled to the value of the tanks the Government had seized).
191. *See id.* at 83,628-29.
192. *See id.*
193. *See id.* at 83,629.
194. *See id.* at 83,630.
cost of performing the contracts subject to adjustment. The fact that this equitable adjustment would effectively eviscerate the new CAS 413 is of no matter; it merely confirms that the equitable adjustment is properly measured because it returns both parties to the position they were in prior to the change. 195

V. GOVERNMENT CLAIMS UNDER THE FAR COST PRINCIPLES

A. Computing the "Government's share" Under the Cost Principles

The circumstances that can trigger a government claim to surplus pension assets under the FAR cost principles, until recently, have been far more limited than those under CAS 413-50(c)(12). Before September 20, 1989, only the actual reversion of pension plan assets to the contractor gave rise to any government entitlement. In NI Industries, Inc., 196 the ASBCA held that the Credits provision gave the Government the right to share in the reversion of funds resulting from the termination of a contractor's overfunded defined benefit pension plan, but only to the extent that the reversion corresponded to government payments made (1) under open cost-reimbursement and flexibly priced contracts and (2) under closed cost-reimbursement contracts for which the contractor executed an assignment to the Government of refunds, rebates and credits, as required by the Allowable Cost, Fee & Payment clause. 197

In reaching this result, the Board found that the Credits provision, the Allowable Cost, Fee and Payment clause applicable to cost-reimbursement contracts, and the Incentive Price Revision clause contained in fixed-price-incentive contracts, obligated the contractor to share any refunds stemming from costs for which the Government had reimbursed the contractor. 198 Where a contract has not been "closed," the Board explained, these clauses preserve the Government's right to adjust the price or cost of the contract to account for any refunds or credits received by the contractor, which are attributable to costs for which the Government has reimbursed it. 199 On the other hand, under "closed" contracts, where the

197. See id. at 122,912-15. Notably, because NI Industries terminated its plan in 1983, prior to the 1989 amendment to the FAR, FAR 31.205-6(j)(4) had no effect upon the Board's consideration of the case.
198. See id. at 122,914-15 (holding that the Credits provision requires the contractor to credit to the Government any reversion costs under flexible, open contracts).
199. See id.
work has been completed and final payment has been made, the Government’s right to a share of the reversion is based upon the contractor’s execution of an assignment to the Government of refunds, rebates, or credits, pursuant to the Allowable Cost, Fee and Payment clause. 200

For contracts awarded on or after September 29, 1989, FAR 31.205-6(j)(4) and the former Termination of Defined Benefit Pension Plans clause (now called the Pension Adjustments and Asset Reversions clause), which purportedly applies whether the contract is open or closed, broadens the circumstances that can trigger a Government claim, from actual reversion of plan assets to either actual or constructive reversions. 201 This revision expands the reach of the Government’s share to contracts and subcontracts subject to the FAR cost principles and those for which the contractor has submitted cost or pricing data. 202 Accordingly, the Government may assert a claim under contracts, such as firm-fixed-price contracts, that do not incorporate the FAR cost principles. An amendment, effective August 22, 1991, further broadens the circumstances that can trigger a Government claim, to include the transfer of pension assets to another employee benefit plan fund without the contractor’s first having entered into an advance agreement, even if the assets remain in a trust for the exclusive benefit of employees and their beneficiaries, and neither actually nor constructively revert to the contractor. 203

With the revision that took effect on December 29, 1998, the FAR cost principles may now cover an even wider variety of triggering events than the segment closing provisions of CAS 413.50(c)(12). For contracts awarded on or after that date, a pension adjustment is required when there is a segment closing, pension plan termination, or curtailment of benefits, and in “all other situations where assets revert to the Contractor, or such assets are constructively received by it for any reason.” 204 The first three events are the same as those covered by CAS 413.50(c)(12): the Government’s “equitable share” under FAR 31.205-6(j)(4)(i) is computed in the same manner as it is under CAS 413, except that “[f]or contracts and subcontracts that are not subject to CAS” the numerator of the fraction is “the sum of the pension plan costs allocated to all non-CAS-covered contracts and subcontracts that are subject to [FAR] Subpart 31.2 or for which [the contractor submitted] cost or pric-

200. See id. at 122,915.
202. See id.; see also § 31.201-1(a).
203. See id. § 31.205-6(j)(3)(v).
For the "other situations" where assets either revert to or are constructively received by the contractor, FAR 31.205-6(j)(4)(ii) provides that:

[T]he contractor shall, at the Government’s option, make a refund or give a credit to the Government for its equitable share of the gross amount withdrawn. The Government’s equitable share shall reflect the Government’s participation in pension costs through those contracts for which cost or pricing data were submitted or that are subject to Subpart 31.2. Excise taxes on pension plan asset reversions or withdrawals under this paragraph (j)(4)(ii) are unallowable in accordance with 31.205-41(b)(6).

Curiously, however, the December 1998 revision deletes the sentence in subparagraph (j)(3)(v), saying that the "withdrawal of assets from a pension fund and transfer to another employee benefit plan fund" without advance agreement is deemed a constructive withdrawal and receipt of those funds by the contractor under paragraph (j)(4). In its place is added a far more limited provision: "If the withdrawal of assets from a pension fund is a plan termination under ERISA, the provisions of paragraph (j)(4) of this subsection apply." Because paragraph (j)(4)(i) governs plan terminations, and because employers generally cannot withdraw pension assets from a pension fund without terminating the plan (except to make IRC section 420 transfers), it is unclear when, if ever, 31.205-6(j)(4)(ii) applies. The term "constructively received" is not defined in the FAR. It is, however, a term frequently used in the tax laws, and in that context is commonly understood to mean income subject to the "unfettered control" of the taxpayer. Without a plan termination,

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205. Id. In other words, the CAS 413.50(c)(12) equation is modified as follows:

\[
\frac{\text{aggregate amount of pension costs allocated during a representative period of years to all non-CAS-covered contracts and subcontracts that are subject to FAR Subpart 31.2 or for which the contractor submitted cost or pricing data)}{(\text{divided by}) \text{ (pension costs assigned during the same representative period of years}} \times \text{ (times}) \text{ (surplus} - (\text{minus}) \text{excise taxes) } = \text{(equals)}(\text{government share of total}).
\]

See id.

206. See id. (emphasis added).

207. 48 C.F.R. § 31.205-6(j)(3)(v) (emphasis added).

208. 63 Fed. Reg. at 58,598.

209. See Hornung v. Commissioner, 47 T.C. 428, 434 (1967) (explaining that "[t]he basis of constructive receipt is essentially unfettered control by the recipient"); see also 26 C.F.R. § 1.451-2(a) (1998):

Income although not actually reduced to a taxpayer’s possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of
the funds remain in trust and cannot lawfully be removed. Hence, absent a plan termination, the contractor would neither actually nor constructively receive any of the pension funds.210

B. Limitations on Government Claims Under the Cost Principles

Similar to CAS 413, there are significant limitations on any claim of government entitlement based upon the FAR cost principles. Most significantly, the applicable FAR cost principles are those in effect at the time of contract award, and the FAR Council, like the CAS Board, lacks authority to change the cost principles retroactively. Each of the clauses that incorporates the FAR cost principles also expressly states that the cost principles incorporated are those in effect at the time of contract award.211 Furthermore, the cost principles in effect at the time of contract award continue to apply for the life of the contract, even if the contract contains options that are exercised after amendment of the cost principles.212 As a matter of both logic and contract interpretation, it is a necessary corollary to the principle that the applicable cost principles are those in effect at the time of contract award that later amendments to the cost principles do not apply retroactively. Furthermore, as discussed above, regulations are presumed not to apply retroactively unless both the underlying statute and the regulatory language expressly require that result.213

The Administrator of OFPP promulgates the FAR pursuant to the authority contained in Section 6 of the OFPP Act.214 Nothing in the Act

intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Id.

210. See 26 C.F.R. § 1.451-2(a) (giving an example of how bonus stock credited to employees, but unavailable to them, is not "received").

211. See supra notes 20-22; see also 48 C.F.R. § 252.243-7001 (explaining that “[w]hen costs are a factor in any price adjustment under this contract, the contract cost principles and procedures in FAR part 31 and DFARS Part 231, in effect on the date of this contract, apply.”); Boeing Aerospace Operations, Inc., 94-2 B.C.A. (CCH) ¶ 26,802, at 133,281 n.4 (1994) (recognizing that the CAS Board will rely on the regulations in effect at the time of contract performance when the contract is performed before the effective date of the amended regulations).

212. See Boeing Aerospace Operations, Inc., 94-2 B.C.A. (CCH) at 133,281 n.4.

213. See Landgraf v. USI Film Prods., 511 U.S. 244, 269-71 (1994) (stating that a court will only construe statutes and regulations to apply retroactively if their language expressly requires that result); Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988) (concluding that “a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms.”).

either expressly or implicitly gives the Administrator authority to promulgate retroactive regulations. Not only is there no statutory authority to apply the amendments retroactively, but the amendments themselves do not say that they have retroactive effect. Indeed, with respect to the September 1989 revision to FAR 31.205-6(j)(4), there is cogent evidence that the drafters intended the revision not to be retroactive, because they intentionally deleted the retroactive provisions of the proposed rule in the face of adverse public comment. The proposed rule, as published on February 9, 1987, would have added a detailed “termination of defined benefit pension plans” provision to FAR 31.205-6; this would have included several subsections detailing the manner in which the Government’s “equitable share” would be calculated. Of particular interest, the proposed paragraph (j)(4)(ii) would have provided that:

The Government's share of the adjustment of prior periods’ pension costs, calculated for each segment in accordance with paragraph (j)(4)(i) of this section, shall be the product of such adjustment (net of any amount prefunded) and the ratio of pension expense absorbed by all Government contracts and subcontracts (including Foreign Military Sales) to total pension costs incurred during the 10-year period preceding the date of plan termination, or the period from the inception date of the plan being terminated, whichever is shorter.\(^{215}\)

Confirming that they initially intended the provision to be retroactive, the drafters’ comments explained that the drafters designed the proposed provision to “serve as a ‘trigger’ to initiate the process of sharing the proceeds of a termination on a basis proportionate to the amount of pension costs absorbed by all Government contracts, competitive and noncompetitive, fixed price and cost reimbursement types, and small purchases and major purchases.”\(^{216}\) Nevertheless, as a result of the public comments, the drafters dropped the retroactive provision and all of the detailed subsections from the final rule.\(^{217}\) Hence, the regulatory history confirms that the drafters of the new paragraph (j)(4) focused on the issue of retroactivity and decided against it.\(^{218}\)


\(^{216}\) Id. at 4085.


\(^{218}\) See id.; cf. Landgraf, 511 U.S. at 255-56 (reasoning that because the retroactivity provisions of the first Act proved controversial and resulted in a presidential veto, “[t]he
Thus, contrary to the position suggested in the Defense Contract Audit Agency (DCAA) Contract Audit Manual, FAR 31.205-6(j)(4) does not, and indeed cannot, retrospectively "trigger" inclusion of contracts awarded before the effective date of the amendment, September 20, 1989. As discussed with regard to CAS 413 above, even if the only contracts to actually be adjusted were awarded after the effective date of the amendment, using pre-amendment contracts to determine the amount of the Government's share would improperly give the amendment retroactive effect. Hence, the only contracts that may be used in determining the Government's share under FAR 31.205-6(j)(4) are those awarded after September 20, 1989. So, too, the only contracts that may be used in determining the Government's share under FAR 31.205-6(j)(4) as revised, effective December 29, 1998, are those contracts awarded on or after that date.

Many contractors with significantly overfunded pension plans ceased making contributions before the 1989 amendment took effect. For those contractors, the sole basis for any government claim of entitlement, at least with regard to any contracts to which the contractor allocated pension costs, must be found, if at all, in the FAR cost principles and the Credits provision in particular, as the regulation existed before the 1989 amendment. Nevertheless, there are significant limitations on the Government's rights to share in excess pension costs under the Credits provision.

First, the Credits provision provides no basis for adjustment of firm-fixed-price contracts. Indeed, the ASBCA in *NI Industries* expressly holds that the Government is not entitled to that portion of the reversion corresponding to fixed-price contracts. In so holding, the Board spec-
cifically endorses the position the Cost Principles Committee expressed in the latter's review of DAR Case 85-180: although the Government's right to a share of the reversion resulting from payments made under cost and fixed-price-incentive contracts has had adequate support in the Credits provision and the Allowable Cost, Fee and Payment and Incentive Price Revision clauses included in those contracts, the Committee "'knows of no contract clause that provides a right [to] recapture' a reversionary credit under fixed price contracts."222 The ASBCA also notes that the Assistant Secretary of Defense for Acquisition and Logistics further bolsters the Cost Principles Committee's belief. In 1986 the Assistant Secretary "directed the military departments, [the Defense Logistics Agency,] and [the] DCAA to enter into advance agreements . . . to protect the Government's interest in [the reversions] resulting from a pension plan termination."223 Additionally, the ASBCA holds, the Credits provision provides no basis for adjustment of closed flexibly priced contracts, nor closed cost-reimbursement contracts for which the Government has failed to obtain an assignment of credits.224

Furthermore, even with regard to open cost-reimbursement and flexibly priced contracts, certain years of the contracts may be "closed" for all practical purposes, because the parties already have negotiated final indirect cost rates. By definition, final indirect cost rates are rates "established and agreed upon by the Government and the contractor as not subject to change."225 In other words, by establishing final indirect cost rates, the cognizant administrative contracting officer unconditionally agrees that the rates are final and not subject to adjustment, whether under the Credits provision or any other cost principle.226

223. Id. DAR Case 85-180 led to promulgation of the 1989 changes to the compensation for personal services cost principle and FAR credits provision, adding the new section 31.205-6(j)(4), captioned "Termination of Defined-Benefit Pension Plans." See id. The DAR Council explains that the "'paramount purpose'" of DAR Case 85-180 "'was to provide contractual coverage for fixed-price contracts.'" Id.

224. Id. at 122,906.


227. See Institutional & Envtl. Management, Inc., 90-3 B.C.A. (CCH) ¶ 23,188, at 116,072 (1990) (under the doctrine of finality, the "Government, like any other contracting party, is bound by acts of the contracting officer within the scope of employment"); Teledyne Continental Motors (Gen. Prods. Div.), 85-3 B.C.A. (CCH) ¶ 18,472, at 92,786 (stating that the government is bound "by agreements entered into by it with the contractor").
VI. STRATEGIES FOR AVOIDING, LIMITING, OR DELAYING GOVERNMENT CLAIMS

Even without making a frontal assault on the validity of the revised CAS 413, it may be possible to structure pension transactions in a way that avoids, limits, or at least delays the Government’s ability to claim surplus pension assets. In the 1980s, surplus pension assets helped to fuel leveraged buyouts: acquiring companies borrowed capital to purchase a company with an overfunded pension plan, immediately terminated the plan, purchased annuities to cover vested pension benefits, and used the remaining pension assets to repay the borrowed capital. The punitive excise taxes imposed in 1990 effectively put an end to this strategy. The September 1989 revision to the FAR cost principles similarly chilled this termination-and-recapture strategy. The 1990s have seen a somewhat different, more creative use of surplus pension assets. Some companies with underfunded plans have acquired companies with surplus pension assets and then merged the acquired company’s overfunded plan with their own underfunded plan. Other companies have allowed the seller to keep surplus pension assets as a means of effectively increasing the purchase price for the business unit. Because neither strategy requires terminating the pension plan or withdrawing pension assets, excise taxes are not applicable. Whether these new strategies

228. See generally GENERAL ACCOUNTING OFFICE (GAO), REPORT, TERMINATIONS, ASSET REVERSIONS, AND REPLACEMENTS FOLLOWING LEVERAGED BUYOUTS (1991) (reporting that in 20% of the 121 leveraged buyouts examined, the companies terminated overfunded pension plans and replaced them with new plans, recouping the surplus pension assets).


232. See, e.g., Barry B. Burr, Overfunded Pensions of Value Again, PENSIONS & INVESTMENTS, Sept. 16, 1996, at 10 (illustrating Boeing’s and Keystone’s use of such practices); Dean Takahashi, Loral, Pentagon Settle Dispute Over Use of Pension Funds, L.A. TIMES, Jan. 10, 1993, available in 1993 WL 2362907 (reporting that Loral Corp. used Ford Aerospace’s overfunded pension assets to acquire Ford Aerospace: “In addition to paying $715 million in cash, Loral allowed Ford Motor Co. to keep $213 million of Ford Aerospace’s pension assets. Analysts said this drove up the cost of the acquisition and allowed Loral to beat out other bidders.”); see also WHX to Start New Fight for Teledyne, L.A. TIMES, Feb. 15, 1995, at D2 (reporting that WHX planned a proxy fight for control of Teledyne to gain access to the company’s pension surplus by merging its own underfunded plan with Teledyne’s plan).

are an effective means for government contractors to avoid, limit, or delay government claims for surplus pension assets depends on how the transactions are structured.

As long as there is no segment-closing event as defined in CAS 413 and pension assets do not actually or constructively revert to the contractor, the Government has no basis under the current regulations to assert a claim. For example, a company with an underfunded pension plan could acquire a company with surplus pension assets, merge the two plans, and effectively use the surplus pension assets of the acquired company to fund its own pension plan. ERISA permits the merger of pension plans or transfer of pension assets and liabilities between pension plans, provided “each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated).”

Provided that all of the acquired company’s pension assets and liabilities are transferred to the acquiring company, CAS 413 requires no segment closing adjustment. Even absent transfer of all of the assets and liabilities, if the transaction is structured such that the ownership of the segment does not change—i.e., through a merger or acquisition by stock sale of the segment’s parent, where the parent corporation survives the transaction, albeit with new stockholders—no segment closing would occur. As well, so long as the pension assets remain in a pension trust and do not actually or constructively revert to the contractor, no pension adjustment is required by FAR 31.205-6(j)(4) or the Pension Adjustments and Asset Reversions clause.

Nevertheless, because the two plans had different ratios of market value of assets to actuarial accrued liabilities, separate segment accounting is required for government contracting purposes. In other words, although the plans were merged into a single plan, in measuring the annual pension cost for its government contracts, the contractor must account for the plan as though it were still two separate plans, separately

234. See 48 C.F.R. §§ 9904.413-30(a)(20), 9904.413-50(c)(12) (1998); see also supra note 71 and accompanying text.
235. See supra notes 209-10 and accompanying text.
237. See 48 C.F.R. § 9904.413-50(c)(v).
238. See supra note 71 and accompanying text (providing an example of such a case).
240. See id. § 9904.413-50(c)(3).
tracking gains and losses. As a practical matter, the net result is that when the contractor begins making pension plan contributions for employees of the acquired segment, the contributions may not be reimbursable under its government contracts, because, based on the segment accounting records, the acquired segment's plan is still fully funded. Moreover, if the acquired segment is subsequently closed, or its plan assets revert to the contractor, the Government's claim will be measured using segment accounting. Hence, this strategy can only delay, not reduce, a government claim.

A strategy that may reduce the Government's claim is making a pre-segment-closing division of the segment's pension plan into separate plans (either actually or by segment accounting records), one covering active employees and one covering inactive (retired) employees. CAS 413-50(c)(9) permits “[c]ontractors who separately calculate the pension cost of one or more segments [to] calculate such cost either for all pension plan participants assignable to the segment(s) or for only the active participants of the segment(s).” If the contractor elects to create a segment for inactive participants of the pension plan, it must make an initial, proportionate allocation of plan assets and liabilities to the inactive segment. Effectively, this permits the contractor to make a one-time, pro-rata transfer of the pension surplus to the retiree segment. Thereafter, as employees retire and transfer to the inactive segment, or move from the inactive segment to the active segment, the amount of pension assets that may be transferred is limited to the amount of “actuarial accrued liabilities[,]” determined using the accrued benefit cost

241. See id. CAS 413-60(c)(11) illustrates this concept. The illustration involves the sale of a segment with the transfer of all assets and liabilities to the buyer. See id. § 9904.413-60(c)(11). Although a segment closing adjustment is not required, the illustration concludes that separate segment accounting is required: “If the transferred liabilities and assets of the segment are merged into the buyer’s pension plan which has a different ratio of market value of pension plan assets to actuarial accrued liabilities, then pension costs must be separately computed in accordance with 9904.413-50(c)(3).” Id.

242. Additionally, FAR 31.205-6(j)(3)(v) provides that increased costs resulting from transferring pension assets to another plan are unallowable unless the contractor first entered into an advance agreement with the Contracting Officer. See id. § 31.205-6(j)(3)(v).

243. Id. § 9904.413-50(c)(9).

244. See id.; see also id. § 9904.413-60(c)(6). Although the contractor may elect to establish a separate segment for inactive participants (who are presumably no longer working on any government contracts), the annual pension cost for the active segment nonetheless includes an “allocated portion of the pension cost calculated for the inactive participants.” Id. § 9904.413-50(c)(9). Accordingly, this election does not require the contractor to forgo charging the Government for annual pension costs for the retirees in the inactive segment. Presumably, however, if there are surplus pension assets, the contractor is no longer making contributions to the plan.
The value of making such an election is that it may significantly reduce the amount of pension surplus attributable to the active segment, thereby reducing the amount of the Government's claim if the active segment were to be closed. The inactive segment, on the other hand, could potentially remain "open" indefinitely, provided the contractor does not terminate the plan or otherwise withdraw plan assets.

Another potential means of reducing the amount of the Government's claim is to offset the pension surplus by the amount of unfunded Post-retirement Benefits (PRB) liability attributable to the segment. Until implementation of the Financial Accounting Standards Board's Statement of Financial Accounting Standards (FAS) No. 106 in 1993, most contractors accounted for PRB costs on a pay-as-you-go basis. FAS 106 requires that liability for PRBs be recognized on an accrual basis during the years of service prior to the date when the employee becomes eligible for benefits. Since 1991, FAR 31.205-6(o) has effectively restricted contractor ability to accrue (or at least to be reimbursed for accruing) funds to cover the past-service PRB obligations. As a result, many government contractors have a sizeable unfunded PRB liability. Although there is currently no CAS provision expressly on point, the CAS Board's Staff Discussion Paper on PRB costs opines that it is "equitable" to reduce the CAS 413 pension adjustment by the amount of unfunded PRB liability. In particular, the Staff Discussion Paper states that it is not necessary to "specifically provide that any adjustment charge for unfunded post-retirement benefit liabilities may be used as an offset to any CAS 9904.413-50(c)(12) adjustment credit for overfunded pension plans," because:

When a segment closes, any adjustment amount measured for post-retirement benefit plans is to be reported to the parties for consideration when negotiating the overall settlement of costs and credits associated with the segment closing. The parties are expected to negotiate an agreement on the treatment of any

245. Id. § 9904.413-50(c)(8).
246. See Employers' Accounting for Postretirement Benefits Other Than Pensions, Statement of Financial Accounting Standards No. 106, § 2 (Financial Accounting Standards Bd. 1990) ("Most employers have accounted for postretirement benefits on a pay-as-you-go (cash) basis. As the prevalence and magnitude of employers' promises to provide those benefits have increased, there has been increased concern about the failure of financial reporting to identify the financial effects of those promises.").
247. See id. at §§ 45-62.
post-retirement benefit segment closing adjustment and the CAS 9904.413-50(c)(12) pension adjustment that is equitable based on the facts and circumstances of the particular segment closing.  

Such an offset seems particularly appropriate and equitable when the pension surplus arises during the same period and involves the same workers as the PRB liability, because the “undercontribution” to PRB costs effectively reduces any government “overcontribution” to the pension plan.

VII. CONCLUSION

In summary, despite its best efforts to change the rules retroactively, the Government has little entitlement to contractors’ accumulated surplus pension assets. Although contracting officers will undoubtedly continue to assert and vigorously pursue pension adjustment claims, there are a number of potential legal challenges. Additionally, with careful planning, contractors may be able to delay, limit, or even avoid such claims.