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Fed. Circ. Says DOD Can't Deny $253M Northrop Cost Claim

By **Daniel Wilson**

Law360 (November 15, 2019, 5:59 PM EST) -- The Federal Circuit ruled Friday that the Defense Contract Management Agency can't deny Northrop Grumman Corp.'s claim for $253.4 million in retiree benefit costs after the company switched cost accounting methods because Northrop more than offset the difference through a benefit contribution cap.

Although the DCMA argued that Northrop couldn't claim reimbursement for $253.4 million in retirement benefits as part of its accounting switch, because Northrop's original accounting method didn't comply with the Federal Acquisition Regulation, or FAR, that argument ignores the totality of the circumstances, a three-judge panel ruled in a precedential decision.

In isolation, that claim could be considered unallowable, the panel found. But simultaneous with its switch in accounting methods, Northrop put a cap on future contributions it would make to its retiree benefits plans, saving $307 million in future cost obligations, the panel noted.

That more than made up the difference and means the government will effectively never be charged for the disputed costs, the panel said.

"Although the amendment did not affect the allowability of the disputed $253 million, it cannot be viewed in isolation from Northrop's adoption of [a different accounting] method because the amendment completely eliminated Northrop's transition obligation," the panel said.

Representatives for Northrop and the DCMA did not immediately respond to requests for comment Friday.

Under the FAR, contractors can seek reimbursement from the government for post-retirement benefit costs — like health care or life insurance — for employees who work on federal contracts.

As part of a 1995 FAR amendment, Northrop was supposed to switch to a benefit accounting method in line with a Financial Accounting Standards Board rule. But it continued to use its existing method for calculating those costs based on the Deficit Reduction Act for more than a decade.

The primary difference between the two methods is that the board rule uses a methodology that includes future increases in medical costs, with costs decreasing over time, while the Deficit Reduction Act method is calculated based on current costs, with costs increasing over time, according to the opinion.

Northrop's continued use of its existing method resulted in lower reimbursement costs for the government at the time, so the government continued to sign off on Northrop's accounting after 1995, even though it wasn't compliant with the FAR.

But Northrop, acting under the view that the accounting board rule set a ceiling for allowable post-retirement benefit costs, eventually determined that the continued use of the Deficit Reduction Act method would exceed that ceiling by 2015, and moved to switch over to the accounting board rule in 2006.

As part of that switch, it needed to calculate a "transition obligation," accounting for the difference in cost had it used the accounting board rule between 1995 and 2006 — $304.7 million — and submitted its transition obligation claim to the DCMA in November 2006.

The agency, however, disallowed $253.4 million of the claimed $304.7 million — the remainder came from contracts awarded prior to 1995 — saying Northrop had failed to timely assign the unfunded difference because of its failure to switch accounting methods in 1995.

Northrop took the dispute to the Armed Services Board of Contract Appeals, which found in 2017 that Northrop failed to comply with the FAR, technically making its claim unallowable under the regulation.

But the board also found that an amendment to Northrop's benefit plans capping the company's contributions, introduced at the same time as its intended switch to the accounting board rule, saved $307 million from its future obligations, which for accounting purposes were effectively the same costs included in the disputed transition obligation claim.

And under the relevant FAR clause, cost claims stemming from alternative accounting methods are only unallowable to the extent they exceed the costs that would have been allowed using the accounting board rule, according to the board. Northrop's use of the Deficit Reduction Act method, combined with its cost cap, meant there were no excessive costs, and the government had suffered no damages, the board said.

Circuit Judges Sharon Prost, William C. Bryson and Jimmie V. Reyna sat on the panel for the Federal Circuit.

The DCMA is represented by Daniel B. Volk, Joseph H. Hunt, Robert E. Kirschman Jr. and Patricia M. McCarthy of the U.S. Department of Justice's Civil Division and Robert L. Duecaster of the DCMA's Contract Disputes Resolution Center.

Northrop is represented by Donald B. Verrilli Jr. and Ginger D. Anders of Munger Tolles & Olson LLP and Charles Baek, Stephen J. McBrady and Nicole J. Owren-Wiest of Crowell & Moring LLP.

The case is Secretary of Defense v. Northrop Grumman Corp., case numbers 18-1945 and 18-1990, in the U.S. Court of Appeals for the Federal Circuit.

--Editing by Bruce Goldman.
