COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS
4401 Wilson Boulevard, Suite 1110
Arlington, Virginia 22203
703-875-8059

August 26, 2013

General Services Administration
Regulatory Secretariat (MVCB)
ATTN: Hada Flowers
1800 F Street NW., 2nd Floor
Washington, DC 20405

Re: **FAR Case 2012–025 - Federal Acquisition Regulation - Applicability of the Senior Executive Compensation Benchmark**
CODSIA Case 06-13

Dear Ms. Flowers:

On behalf of the Council of Defense and Space Industry Associations (CODSIA)[1], we are pleased to submit the following comments on the proposed rule titled "**Applicability of the Senior Executive Compensation Benchmark" (FAR Case 2012-025)** which was published in the Federal Register on June 26, 2013.

The Proposed Rule Can Not Be Retroactively Applied As It Would Create a Breach of Contract

As is explained below, retroactive application of a change to a cost principle is a breach of contract, for which the Government must pay damages. It does not matter if this change is effected through a statute or through a regulation; either action is a breach of contract entitling contractors to damages. Thus, if the Government attempts to apply the modified cost principle retroactively to contracts formed prior to the change, the Government must pay damages.

Indeed, this concept is expressly incorporated into the Federal Acquisition Regulation. Specifically, FAR 1.108(d) states that changes to solicitations and contracts awarded

[1] CODSIA was formed in 1964 by industry associations with common interests in federal procurement policy issues at the suggestion of the Department of Defense. CODSIA consists of six associations – the Aerospace Industries Association (AIA), the American Council of Engineering Companies (ACEC), the National Defense Industrial Association (NDIA), the Professional Services Council (PSC), TechAmerica, and the Chamber of Commerce of the United States. CODSIA's member associations represent thousands of government contractors nationwide. The Council acts as an institutional focal point for coordination of its members' positions regarding policies, regulations, directives, and procedures that affect them. A decision by any member association to abstain from participation in a particular case is not necessarily an indication of dissent.

after the effective date of the contract, can only be applied to existing contracts with appropriate consideration. This concept is incorporated into contracts through the Allowable Cost and Payment Clause at FAR 52.216-7(a)(1) which states, in relevant part:

> "The Government will make payments to the Contractor when requested as work progresses… in amounts determined to be allowable by the contracting Officer *in accordance with Federal Acquisition Regulation (FAR) subpart 31.2 in effect on the date of this contract*…" [emphasis added]

In section 803(c)(2)) of the Fiscal Year 2012 National Defense Authorization Act, Congress stated that the expanded reach of the compensation cap ``shall apply with respect to costs of compensation incurred after January 1, 2012, under contracts entered into before, on, or after the date of the enactment of this Act" (which was December 31, 2011). This proposed rule would amend FAR 31.205-6(p) to require that the incurred compensation costs for all contractor employees on all DoD, NASA, and Coast Guard contracts awarded on or before December 31, 2011, be subject to the senior executive compensation amount.[2]

Based on well-settled judicial precedent the 2011 congressional action, if implemented retroactively, would cause the government to breach all of the contracts that were awarded before the effective date of the change to the relevant cost principles. For this reason, CODSIA strongly opposes this proposed rule.

In the background section of the preamble to the proposed rule the FAR Council properly states:

> "There are challenges with respect to the retroactive application of section 803 (*i.e.,* to the application of section 803 to contracts awarded before the enactment of section 803). The implementation of section 803 is similar to the implementation of section 808 of the National Defense Authorization Act for Fiscal Year 1998 (Pub. L. 105–85, November 18, 1997) which imposed a cap on Government contractor's allowable costs of ''senior executive'' compensation. Section 808, like section 803, retroactively applied to contracts that already existed on the date of its enactment; both statutes contain text which applied the statute to contracts awarded before, on, or after the date of enactment of the underlying act. In litigation on the application of section 808 to contracts awarded before the date of the enactment of the statute, the courts held that section 808 breached contracts awarded before the statutory date of enactment (*General Dynamics Corp.* v. *U.S.,* 47 Fed. Cl. 514 (2000); and *ATK Launch Systems, Inc.,* ASBCA 55395, 2009–1 BCA ¶ 34118 (2009))."

[2] The background portion of the preamble to the Proposed Rule provides that: "DoD will separately handle the implementation of authority provided by 10 U.S.C. 2324(e)(1)(P), as amended by section 803(a), in which Congress has authorized the Secretary of Defense to establish 'one or more narrowly targeted exceptions for scientists and engineers upon a determination that such exceptions are needed to ensure that the Department of Defense has continued access to needed skills and capabilities.'"

> "For these reasons, DoD, GSA, and NASA are implementing section 803 with both an interim rule and a proposed rule. The separate interim rule (FAR Case 2012–017) addresses the prospective application of section 803, *i.e.,* to contracts awarded on or after its enactment (December 31, 2011). This proposed rule addresses the retroactive application of section 803 to contracts that had been awarded before its enactment. In other words, under this bifurcated approach, DoD, GSA, and NASA are implementing section 803 through the interim rule for contracts awarded on or after the date of enactment (December 31, 2011) and, at the same time, DoD, GSA, and NASA are addressing in this proposed rule the retroactive application of section 803. DoD, GSA, and NASA seek public comments on both the interim and proposed rules (and, on this proposed rule, especially with respect to the potential complexities associated with applying section 803 to contracts that had been awarded before the date of its enactment)."

This basic and fundamental principle was recognized in both cases under which the matter was considered in the late1990s. The Government attempted to apply retroactively a change to the very same cost principle at issue here, and attempted to avoid compensating the contractors for the change. Contractors challenged the action before the U.S. Court of Federal Claims and the Armed Services Board of Contract Appeals. Both the Court and Board rejected the Government's attempt.

The holdings in the General Dynamics and ATK Launch Systems decisions cited in the preamble to the proposed rule make it clear that Section 803 may not be applied to contracts entered into on or before Dec 31, 2011. In fact, in accordance with the referenced decisions, the OFPP Act, and the contract clause found at FAR 52.216-7, "Allowable Cost and Payment", Section 803 and the implementing changes for FAR 31.205(p) may not be applied to any contracts that were entered into on or before the subsequently established effective date of any interim or final rule without the government causing immediate contract breaches to all relevant contracts citing to FAR 31.205-6(p) as an element of performance.

In General Dynamics Corp. v. U.S., 47 Fed. Cl. 514 (2000), the National Defense Authorization Act for Fiscal Year 1998, Public Law No. 105-85, 111 Stat. 1629, was enacted on November 18, 1997. Section 808 of the Act imposed a cap on defense contractors' allowable costs of "senior executive" compensation by making unallowable all such costs that exceed a "benchmark compensation amount." The cap applied to all senior executive compensation costs incurred by defense contractors after January 1, 1998, regardless of whether the contracts were entered into after January 1, 1998 or were already in existence prior to January 1, 1998. Because GD paid compensation to some of its senior executives that exceeded the cap, but which were incurred prior to the date of the enactment of Section 808, GD was adversely impacted by the government's proposed plan to apply the Section 808 compensation cap retroactively.

GD alleged that the enactment of Section 808 breached a 1996 contract (their "-2100 contract") because the cap was sought to be retroactively imposed on a contract that

had been awarded in 1996, prior to the November 18, 1997 effective date of Section 808, and thus, according to GD, breached the requirement in FAR 52.16-7, “Allowable Cost and Payment” that the contracting officer determine allowable amounts "in accordance with [FAR] subpart 31.2 .... in effect on the date the contract was awarded.”

In finding that application of the statutory cap to contracts awarded before the effective date of the statute constituted a breach of FAR 52.216-7, the Court of Federal Claims held:

> “The contract language is clear and unambiguous -- the provisions of FAR subpart 31.2 in effect on the date of this contract, which were incorporated into Contract -2100 through FAR 52.216-7, govern the determination of allowable executive compensation costs. The statutory cap violated this contract provision. The court finds, therefore, that the enactment of Sec. 808 of the FY 98 Authorization Act breached Contract -2100.” General Dynamics Corp. v. U.S., 47 Fed. Cl. 514 (2000).

Similarly, in ATK Launch Systems, Inc., ASBCA 55395, 2009-1 BCA ¶ 34118 (2009)), ATK Launch Systems, Inc. filed a motion for partial summary judgment at the Armed Services Board of Contract Appeals, contending that the government's failure to fully pay executive compensation costs under contracts entered into prior to November 1997 was a breach of contract. In analyzing FAR 52.216-7, the Board held that it was clear that allowability is determined by the FAR 31.2 cost principles that are "in effect on the date of this contract." As of the "date" of the award of the ATK contracts in question, there was no cap or limit to executive compensation costs under FAR Subpart 31.2 and thus the Board held that no cap could be applied to limit these costs. In granting the ATK motion for partial summary judgment, the Board held that since ATK was denied the ability to include these clearly allowable costs in its rates, the Government was liable for damages for its breach of FAR 52.216-7.

As can be seen from these precedential decisions, the critical issue pursuant to the proposed regulatory scheme to expand executive compensation caps to all contractor employees per Section 803 is whether the Government can legally determine allowability of executive compensation costs under a contract awarded prior to a change in the cost principle by applying other than the version of FAR subpart 31.205-6 (p) in existence on the date any relevant contract was awarded. The Proposed Rule attempts to achieve that exact purpose in defiance of the holdings of the two cited contract breach cases.

In addition, since FAR 31.205-6, “Compensation for Personal Services,” which is part of FAR subpart 31.2, is also being proposed for modification by this Proposed Rule to incorporate the section 803 requirements retroactively, such action would also result in a breach of all contracts to which this portion of the rule is applied, consistent with both the *GD* and *ATK* decisions because the Government would be seeking to determine

allowable costs by applying a version of FAR subpart 31.2 that does not exist until the effective date of any future Interim or Final Rule.

Furthermore this proposed rule is in conflict with Section 803(c)(2) itself. The proposed rule change to FAR 31.205(p)(1)(i)(B) calls for removing the term "December 31, 2011" in lieu of the phrase "December 31, 2011, for costs incurred *until* January 1, 2012." This has the effect of applying the compensation cap for all contractor employees to compensation costs incurred before January 1, 2012. Section 803(c)(2) of the statute that expanded the cap to all contractor employees, however, reads "shall apply with respect to costs of compensation incurred after January 1, 2012" [Emphasis added]. Thus, the proposed regulatory prescription is contrary to the statute and errs by attempting to broaden the applicable period beyond the explicit date prescribed by the statute it relies on.

The preamble to the proposed rule requests input on potential complexities with implementing the rule retroactively. There are several ways to explore the issue of government attempting to impose requirements outside the scope of an existing contract, but there is already a practice among contracting officers to attempt to impose newly minted acquisition provisions and clauses in existing contracts as new rules are finalized without substantive discussion with the contractor about consideration and often regardless whether the contractor consents.

While there are some clauses that provide for automatic updating of contract terms following a change to law or regulation, those are few in number and always applied prospectively and not retroactively (See FAR 243-22, Fair Labor Standards Act – Price Adjustment). Moreover, while FAR 1.108 authorizes COs to make changes to an existing contract, those clause changes (such as 52.216-7) must be bilateral and require consideration from the government to the contractor or will be characterized as a contract breach.

Another complexity would be a commensurate increase in administrative and oversight risk to both contractor and government and a potential for contract claims that would correspond with incorrectly parsing allowable compensation costs into before and after rule timing buckets. It is reasonable to conclude that shifting the regulatory focus to all contractor employees will increase the risk of unwarranted cost disallowance for executive compensation and thus stretch the resources of government audit staff engaged in the incurred cost and closeout processes.

We further note that there are already an escalating number of decisions in recent executive compensation cases (See J.F. Taylor). It is already a highly litigious arena that this rule could be expected to exacerbate.

Finally, from a transactional and contract formation perspective, endorsing a policy of retroactive rules, per the proposed rule, will shift the burden for estimating the cost of the government's requirements from known requirements to one where any potential post-contract rule could cause unpredictable cost impacts to performance unforeseen at

time of proposal submission and make it impossible for contractors to accurately estimate the cost of performance.

The Regulatory Flexibility Act Statement is Incorrect and Should be Corrected

The Regulatory Flexibility Act section of the preamble to the rule states:

> "The proposed rule imposes no reporting, recordkeeping, or other information collection requirements. The rule does not duplicate, overlap, or conflict with any other Federal rules, and there are no known significant alternatives to the rule."

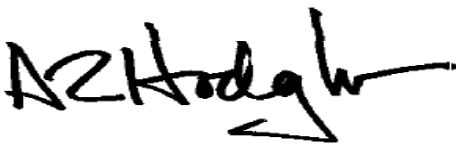
Even though not subject to CAS, numerous small businesses receive contracts that are subject to the FAR Cost Principles and will be required to change the way they manage their cost identification procedures, processes and the manner in which they segregate costs not previously required to account for Section 803. Given the Administration's policy on promoting the use and growth of small businesses, the pressure that sequestration is putting on procurement dollars and the impact on small businesses in particular, small businesses will also have to account for any additional administrative and accounting costs that will be imposed by Section 803 to track and record executive compensation.

Conclusion

The FAR Council has properly identified that any effort to retroactively apply an amended cost principle before the effective date of the regulatory change would trigger a government breach of all affected contracts and exposure to damages. We share in those views. For those reasons, we strongly oppose the proposed rule, recommend it be withdrawn, and recommend that the FAR Council announce its conclusions with respect to this matter.

CODSIA appreciates this opportunity to comment on the Proposed Rule, and we would be pleased to respond to any questions the Council may have on these comments. Trey Hodgkins of TechAmerica serves as CODSIA's project lead on this case and he can be reached at 703-284-5310 or at thodgkins@techamerica.org. Bettie McCarthy, CODSIA's administrative officer, can serve as an additional point of contact and can be reached at codsia@pscouncil.org or at (703) 875-8059.

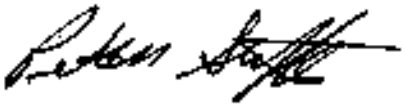
Sincerely,



A.R. "Trey" Hodgkins, III
Senior Vice President
Global Public Sector
TechAmerica

Alan Chvotkin
Executive Vice President & Counsel
Professional Services Council

R. Bruce Josten
Executive Vice President, Government Affairs
U.S. Chamber of Commerce



Peter Steffes
Vice President, Government Policy
National Defense Industrial Association

Christian Marrone
Vice President – National Security & Acquisition Policy
Aerospace Industries Association

Richard L. Corrigan
Policy Committee Representative
American Council of Engineering Companies