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ALERT

Federal Circuit Reverses ASBCA Raytheon Decision – Costs for Lobbying Activity Outside Business Hours and M&A Planning Found Unallowable

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WHAT: The United States Court of Appeals for the Federal Circuit has reversed *Appeals of Raytheon Company*, ASBCA Nos. 60061 et al, 21-1 BCA 37,796 (Feb. 1, 2021), which found Raytheon's policies for tracking potentially unallowable lobbying and corporate organization costs to be reasonable. In the decision, drafted by Judge Prost (joined by Chief Judge Moore and Judge Taranto), the Federal Circuit found that each of Raytheon's policies was inconsistent with the Federal Acquisition Regulation (FAR) Subpart 31 cost principles. The court remanded the matter back to the ASBCA for a determination of the quantum Raytheon owes to the Government.

WHEN: On January 3, 2023, the Federal Circuit issued its decision in *Secretary of Defense v. Raytheon Co. et al.*, case number 2021-2304

WHAT DOES THIS MEAN FOR INDUSTRY: The Federal Circuit's decision will have many government contractors reviewing and revising their internal policies, cost accounting, and disclosure statements in the coming months. The decision upends interpretations of FAR 31.205-22, 31.205-12, and 31.205-27, and draws potentially new lines as to when certain activities may change from allowable to unallowable. The court's conclusion regarding salaries and work outside normal business hours may also affect how other costs may be treated, including some directly associated costs.

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Practice Areas

Cost Accounting and Cost Allowability
Government Contracts

The court's decision addresses two categories of costs that Raytheon incurred.

FAR 31.205-22, Lobbying and Political Activity Costs

Raytheon had an established policy that instructs employees in its government relations department to track the amount of time spent on unallowable activities but, in doing so, consider only time spent during the "scheduled working day," which runs from 8 a.m. to 5 p.m. After the Defense Contract Audit Agency (DCAA) questioned these costs and Defense Contract Management Agency (DCMA) issued a contracting officer's final decision disallowing them, the ASBCA held that the Government failed to carry its burden to prove that Raytheon's costs were unallowable.

The court reversed the Board's decision and held that Raytheon's incurred cost submissions do not accurately reflect the proportion of time that Raytheon's employees spent on unallowable lobbying.

At base, the court disagreed with the Board's finding that "there was no cost to Raytheon or to the government for work outside normal business hours." In reversing the Board's decision, the court emphasized two points. First, citing Black's Law Dictionary, the court described a person's salary as "compensation for work performed on behalf of the company, regardless of when." Second, quoting testimony from Raytheon's employees, the court noted that the Raytheon employees considered work outside of normal business hours to "be a regular part of their work duties." Thus, the court concluded that this "expectation of regular night and weekend work would be factored into the salary paid to the lobbyists." Because the court found that Raytheon paid its employees for this work (and thus incurred a cost), the court concluded that ignoring these costs caused Raytheon to charge the Government for unallowable costs.

The court also briefly noted Raytheon had also argued that it was merely complying with its disclosed accounting practices. But, the court declined to credit this argument because Raytheon had not introduced any disclosure statements as evidence.

FAR 31.205-12, Economic Planning vs. FAR 31.205-27, Organization Costs

The second half of the court's decision relates to the potential line between two cost principles:

- FAR 31.205-12 provides that "the costs of general long-range management planning that is concerned with the future overall development of the contractor's business" are allowable.
- FAR 31.205-27 provides that "expenditures in connection with . . . planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions" are unallowable.

Raytheon had an established policy that drew a bright line depending on whether and when its Acquisition Council formally decides to pursue an acquisition. Unless and until its Acquisition Council decides to submit an "indicative offer," Raytheon considers the costs allowable under FAR 31.205-12. The Board found Raytheon's policy to be "a reasonable reading of the FAR provisions." In doing so, it distinguished between the two cost

principles by describing FAR 31.205-12 as intended to govern "generalized long-range management planning" and FAR 31.205-27 as intended to govern "a specific merger or acquisition."

The court reversed the Board's decision and described Raytheon's policies as "facially inconsistent with the FAR." First, the court explained that there is no overlap between these cost principles because FAR 31.205-12 expressly carves out any costs covered by FAR 31.205-27. Second, the court reasoned that even if it were to accept the premise behind Raytheon's policy—that FAR 31.205-27 applies only to a "specifically identified acquisition"—it would still find that Raytheon's policy snaps the line too late in the process. The court noted, as an example, that under Raytheon's policy it charged as allowable, costs involved in identifying potential acquisitions, and found that these costs are unallowable under FAR 31.205-27. The court also pointed to documents in the appendix showing that Raytheon incurred costs to plan mergers (which are unallowable under FAR 31.205-27) for which Raytheon never submitted indicative offers (which Raytheon would use to treat the costs as allowable under its policy).

Wiley will continue monitoring further developments in this case and in other cost accounting cases pending at the Boards of Contract Appeal, the Court of Federal Claims, and the Federal Circuit.