THE DOCTRINE DISFAVORING RETROACTIVE COST DISALLOWANCE: WHO NEEDS ESTOPPEL ANYWAY?

*Richard C. Johnson, John S. Pachter, Gregory A. Smith & Daniel H. Ramish**

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* *Richard Johnson, John Pachter, and Gregory Smith are Senior Counsel, and Daniel Ramish is Counsel at Haynes and Boone, LLP.*

I. INTRODUCTION

Fifty years ago, the U.S. Court of Claims, predecessor of the U.S. Court of Appeals for the Federal Circuit, established a rule to protect contractors from unfair prejudice associated with delayed government challenges to contractor costs. In its seminal 1971 decision in *Litton Systems, Inc. v. United States*, the court held the government could not impose a retroactive disallowance of contractor costs without giving the contractor "authoritative notice" of the government's changed position with respect to a cost-accounting practice the contractor had reasonably relied upon.[1]

Three decades later, in *Rumsfeld v. United Technologies Corp* (*UT*), the Federal Circuit significantly changed the doctrine of equitable estoppel in the context of a cost disallowance.[2] The contractor had invoked the defense of estoppel to block disallowance of past incurred costs.[3] *UT* imposed a new and misplaced requirement that, in addition to traditional elements applicable between private parties, contractors were required to demonstrate "affirmative misconduct" to establish estoppel against the government.[4] This was a departure from a principle the Supreme Court has noted repeatedly: where the government enters the marketplace, it should be treated as any commercial player.[5]

"Affirmative misconduct" is a difficult bar for contractors to clear, requiring the contractor to overcome the presumption that government officials act in good faith.[6] Before the Federal Circuit's 2003 decision in *UT*, estoppel was a ready tool the boards and courts could use to restrain government overreaching, but the *UT* decision and the Federal Circuit's decision in *United Pacific Insurance* that followed it[7] practically eviscerated the contractor's defense of estoppel in the government contracts context.

Following *UT*, the Armed Services Board of Contract Appeals (ASBCA) issued two decisions suggesting that the "affirmative misconduct" requirement for estoppel extends to retroactive disallowance as well.[8] In its decision on remand in *UT*,[9] and then again fifteen years later in *Technology Systems*, the board reasoned that "retroactive disallowance is a species of estoppel,"[10] and therefore requires the contractor to prove government misconduct. In effect,

1. Litton Sys., Inc. v. United States, 449 F.2d 392, 401 (Ct. Cl. 1971).
2. Rumsfeld v. United Techs. Corp., 315 F.3d 1361, 1377 (Fed. Cir. 2003).
3. *Id.*
4. *Id.*
5. Lynch v. United States, 292 U.S. 571, 579 (1934) ("When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals."); United States v. Winstar Corp., 518 U.S. 839, 895 (1996) (same); Mobil Oil Exploration & Prod. Southeast, Inc. v. United States, 530 U.S. 604, 607–08 (2000) (same).
6. RGW Commc'ns, Inc., ASBCA No. 54495, 05-2 BCA ¶ 32972, at 16,335.
7. United Pacific Ins. Co. v. Roche, 401 F.3d 1362, 1366 (Fed. Cir. 2005).
8. Tech. Sys., Inc., ASBCA No. 59577, 17-1 BCA ¶ 36,631, at 178,387.
9. *See* United Techs. Corp., Pratt & Whitney, ASBCA No. 54512 *et al.*, 06-1 BCA ¶ 33,289, at 165,050.
10. *Tech. Sys., Inc.*, 17-1 BCA ¶ 36,631, at 178,387.

the ASBCA pronounced the doctrine disfavoring retroactive disallowance to be a dead letter. The Federal Circuit's *UT* decision and the ASBCA's reaction to it have engendered confusion and dismay among contractors affected by the unfair practice of retroactive disallowance.

But the doctrine disfavoring retroactive disallowance and equitable estoppel are separate and distinct notions. There is no basis for erecting an unreasonable barrier to the contractor's defense to unfair retroactive disallowance by requiring proof of government misconduct.

The Court of Claims made no mention of "estoppel" in *Litton*,[11] and the courts and boards in the intervening years applied the two doctrines independent of one another, requiring proof of different elements that are not coextensive.[12] To be sure, practitioners and tribunals in analyzing retroactive disallowance have on occasion referred to estoppel and have characterized the two rules as "related precepts."[13] So too, analyses of other equitable principles have drawn parallels to estoppel, such as finality,[14] waiver,[15] and course of dealing.[16] Still other legal theories might come into play, including constructive change,[17] breach of the duty of good faith and fair dealing,[18] and joint interpretation.[19] The courts and boards have not required the contractor to show

11. Litton Sys., Inc. v. United States, 449 F.2d 392 (Ct. Cl. 1971).

12. United Pac. Ins. Co. v. Roche, 401 F.3d 1362, 1366 (Fed. Cir. 2005); *United Techs. Corp.*, *Pratt & Whitney*, 06-1 BCA ¶ 33,289, at 165,050.

13. As will be discussed *infra*, the root of much of the confusion appears to be the decision in *Gould Defense System, Inc.*, ASBCA No. 24881, 83–2 BCA ¶ 16,676.

14. John Cibinic, Jr., James F. Nagle, Ralph Nash, Jr., Administration of Government Contracts 65 (5th ed. 2016) ("Estoppel accomplishes the same result as finality, and because of this the two concepts are often confused.").

15. *See, e.g.*, Universal Painting Corp., ASBCA No. 20536, 77-1 BCA ¶ 12,355, at 597,796 ("While waiver is not in the proper sense of the term a species of estoppel, yet where a party to a transaction induces another to act on the reasonable belief that he has waived or will waive certain rights, remedies, or objections which he is entitled to assert, he will be estopped to insist on such rights, remedies, or objections to the prejudice of the one misled. . . .'" (quoting 31 C.J.S. § 108)); Hughes Aircraft Corp., ASBCA No. 24601, 83-1 BCA ¶ 16396, at 81,516 (analyzing waiver and estoppel together, noting that "we have been cited no Board cases interpreting the 1966 Limitation of Cost clause where an appellant has been granted relief on a waiver/estoppel theory.").

16. *See, e.g.*, Boyd Int'l Ltd. v. United States, 10 Cl. Ct. 204, 206 (1986) (characterizing the contractor's course of dealing argument as asserting "that the Corps' prior course of conduct estops the government from enforcing the otherwise unambiguous language" of the contract).

17. Ford Aerospace & Commc'ns Corp., Aeronutronic Div., ASBCA No. 23833, 83-2 BCA ¶ 16,813 at 83,572, 83,628–29 (Where contractor's use of a value-added base for allocation of G&A complied with CAS 410, the government's direction to use a total cost base was a constructive change.). The Board observed: "Since we decide this appeal on a 'Changes' clause rationale, we need not address possible estoppel consequences of the ACO's administration of the contract with respect to Cost Accounting Standard 410 implementation by appellant." *Id.* at 83,631 n.5.

18. *See, e.g.*, Broad Ave. Laundry & Tailoring v. United States, 681 F.2d 746, 748–49 (Ct. Cl. 1982) (Government was estopped from denying the contractor an equitable adjustment when contractor increased the wages of service contract employees based on an incorrect statement of the Contracting Officer that a new wage determination applied to the contract, so the Court of Claims declined to pass upon the contractor's argument that the government breached its duty to cooperate and act in good faith.).

19. *See* Gould Def. Sys., Inc., ASBCA No. 24881, 83-2 BCA ¶ 16,676, at 82,984 (citing "joint interpretation" as supporting the holding: "Once the Government unequivocally takes its stand and reads and applies the standard in the same manner as the contractor, it is essential that the

"affirmative misconduct" for these legal theories to apply, nor should they. The retroactive disallowance rule is no more subject to this requirement than are the other legal theories.

In addition, equitable estoppel can permanently prevent the assertion of a right, whereas the bar against retroactive disallowance ceases when the government provides authoritative notice to the contractor.[20] Judge Clarke made this point in his dissent in *Technology Systems*:

> Although not discussed in any case law found, I believe it is appropriate to treat retroactive disallowance and traditional estoppel differently. This is because traditional estoppel is a permanent prospective bar to the government's action; retroactive disallowance is not. In retroactive disallowance the government may change its standard and disallow costs it had previously allowed, i.e., the "estoppel" only applies between the previous approval(s) and the point when the government provides notice to the contractor that it will impose a different standard in the future.[21]

Judge Clarke's distinction is supported by case law. *United States v. Georgia-Pacific Co.*, a landmark decision involving assertion of estoppel against the government, illustrates the permanent effect of equitable estoppel.[22] There, the Forest Service entered into a contract with a lumber company stating that the company would donate certain timberlands to the government after the forest growth on the lands had been harvested, in exchange for the land becoming part of a national forest, affording the lumber company additional fire protection.[23] The lumber company harvested some of the lands as planned and conveyed them to the government, but a statute later redrew the boundary of the national forest to include some portions of the land but exclude others.[24] For years thereafter, the government made no claim regarding conveyance of the remaining land and observed the boundaries established by the statute, and the timber company and its successors in interest managed and developed the land and paid taxes and dues for it.[25]

Nearly a decade later, the government brought an action for declaratory relief and specific performance to enforce the thirty-year-old agreement.[26] The Ninth Circuit ruled that although the contract was valid, the government was estopped from enforcing it and asserting title to the timberlands.[27] The Ninth Circuit observed that "equitable estoppel [has] the effect of *absolutely*

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contractor be entitled to rely on that joint interpretation until notified otherwise. This rule is essential to the orderly conduct of business with the Government and is applicable irrespective of whether a Defense Acquisition cost principle or a Cost Accounting Standard is involved."); *see also* Falcon Rsch. and Dev. Co., ASBCA No. 19784, 77-1 BCA ¶ 12,312, at 59,484–85, *reconsideration denied*, 77-2 BCA ¶ 12,795.

20. Tech. Sys. Inc., ASBCA No. 59577, 17-1 BCA ¶ 36,631, at 178,403 (Clarke, J., dissenting).
21. *Id.*
22. *See* United States v. Georgia-Pac. Co., 421 F.2d 92, 95 (9th Cir. 1970).
23. *Id.* at 94–95.
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.* at 105.

precluding a party, both at law and equity 'from asserting rights which might perhaps have otherwise existed . . . .'"[28]

Courts have also recognized the prospective application of equitable estoppel in a context familiar to the Federal Circuit: patents and other intellectual property cases. The Eastern District of Virginia summarized a leading patent equitable estoppel case[29] and its progeny as holding that "estoppel . . . forecloses all relief, past and future."[30] Courts have similarly ruled in copyright infringement suits: "[E]quitable estoppel can be used to prevent a plaintiff from recovering prospective as well as past damages."[31]

By contrast, *Litton* itself firmly established that the bar on retroactive disallowance is entirely backward-looking.[32] The Court of Claims granted the contractor's motion for summary judgment as to costs incurred "prior to and including" the date that "plaintiff was authoritatively informed of the Government's previously ambivalent position," but granted the government's cross-motion for summary judgment as to costs incurred after that date.[33]

Perhaps someday the Federal Circuit will acknowledge the error in its unfortunate decision to burden estoppel against the government with a requirement to show "affirmative misconduct."[34] In the meantime, the doctrine against retroactive disallowance is alive and well. The panel decision in *UT*[35] did not and could not overrule established Court of Claims precedent in *Litton Systems*.[36] As will be discussed, only an *en banc* decision of the Federal Circuit could do that.[37] The separation of the two doctrines in the decisional law is intact. As a result, the bar to retroactive disallowance up to the point the government provides the contractor with "authoritative notice" of its position remains available to curb unjustified government delay in attempting to disallow costs reasonably incurred in reliance on existing rules of allocability and allowability of costs.

This article will first address the need for a rule barring retroactive disallowance of costs. Then, it will review the relevant decisions of the courts and

28. *Id.* at 96 (emphasis added) (citing John Norton Pomeroy, Pomeroy's Equity Jurisprudence §§ 801, 802 (5th ed. 1941) (1905)).

29. A.C. Aukerman Co. v. R.L. Chaides Const. Co., 960 F.2d 1020, 1040 (Fed. Cir. 1992) (en banc), *abrogated on other grounds*, SCA Hygiene Prod. Aktiebolag v. First Quality Baby Prod., LLC, 580 U.S. 328 (2017).

30. Odetics, Inc. v. Storage Tech. Corp., 14 F. Supp. 2d 785, 789 (E.D. Va. 1998), *aff'd*, 185 F.3d 1259 (Fed. Cir. 1999).

31. Legislator 1357 Ltd. v. Metro–Goldwyn–Mayer, Inc., 452 F. Supp. 2d 382, 391 (S.D.N.Y. 2006) (internal citations omitted).

32. *See* Litton Sys., Inc. v. United States, 449 F.2d 392, 401–02 (Ct. Cl. 1971).

33. *Id*.

34. *See*, *e.g.*, James J. Gallagher, *Retroactive Cost Disallowances Revisited: Did the Federal Circuit Commit Error by Failing to Recognize Relevant Supreme Court Precedent When It Decided* Rumsfeld v. UTC*?*, 48 Pub. Cont. L.J. 551, 552 (2019); James J. Gallagher et al., *En Banc Consideration of Government Contract Issues at the U.S. Court of Appeals for the Federal Circuit*, 42 Pub. Cont. L.J. 107, 116 (2012).

35. Tech. Sys., Inc., ASBCA No. 59577, 17–1 BCA ¶ 36,631, at 178,387.

36. *Litton Sys., Inc.*, 449 F.2d at 401.

37. *See* South Corp. v. United States, 690 F. 2d 1368, 1370 (Fed. Circ. 1982).

boards to explain why the holding in *Litton Systems* remains binding precedent and confirm the continued viability of the rule prohibiting retroactive disallowance of costs as a proper defense, where appropriate, to government overreaching. Decisions such as the Court of Federal Claims 2022 decision in *Sikorsky Aircraft Corp.* demonstrate that the courts and boards have remained alert to the unfairness of retroactive disallowances.[38] Proper analysis of these decisions supports optimism that fairness will prevail.

II. THE NEED FOR A RULE BARRING RETROACTIVE DISALLOWANCE

The facts discussed by the Court in *Sikorsky Aircraft Corp. v. United States*, illustrate the need for an equitable principle that prevents the government from belatedly challenging accounting practices.[39] In *Sikorsky*, the court declined to dismiss specific arguments raised by the contractor in its appeal of government claims based on alleged noncompliance with Cost Accounting Standard (CAS) 420 and CAS 403 in the allocation of independent research and development (IR&D) costs where the government accepted Sikorsky's accounting practices for five years before giving notice that it viewed the costs as noncompliant.[40]

The facts in *Sikorsky* illustrate an all too familiar instance of government delays attending its enforcement of the CAS and FAR Part 31 cost principles;[41] delays that are often lengthy and prejudicial to contractors. Thus, for CAS noncompliance claims, the following sequence of events is typical:

1. Contractor submits a cost CAS Disclosure Statement (D/S),[42] after which the Auditor and Contracting Officer (CO) will typically review the D/S for "adequacy"[43] because the CO cannot award a CAS-covered contract until D/S is deemed "adequate."[44]
2. The regulations then require the Auditor and CO to review the D/S for "compliance" with CAS,[45] but no time is specified for a compliance determination, and in too many cases (like *Sikorsky*) the CO fails to issue the required compliance determination, sometimes for years, during which time the contractor prices contracts awarded by the government in reliance on the cost accounting practices reflected in the D/S.
3. In the meantime, the Contractor is required to follow consistently the cost accounting practices reflected in its D/S when accumulating and reporting these costs, which must also be the same as those used to perform other CAS-covered contracts.[46]

38. *See generally* Sikorsky Aircraft Corp. v. U.S., 161 Fed. Cl. 314 (2022).
39. *Id.* at 323.
40. *Id.*
41. *Id.*
42. FAR 52.230-2(a)(1).
43. FAR 30.202-7(a).
44. FAR 30.202-6(b).
45. FAR 30.202-7(b).
46. FAR 52.230-2(a)(1) & (2).

4. In these circumstances, the Contractor is prejudiced when, years later, the CO finds the disclosed practice noncompliant with CAS, requires the contractor to adopt a different ("compliant") practice and requires it to agree to contract price adjustments for every contract affected by the noncompliance.[47]

The operation of the Allowable Cost and Payment clause[48] creates similar problems for contractors in relation to cost disallowances under the cost principles. COs can disallow costs at any time during contract performance, before or after costs are incurred.[49] Costs are often challenged after the fact, following a Defense Contract Audit Agency (DCAA) audit. For government claims based on the asserted unallowable costs under FAR Part 31 (including challenges based on allocability or reasonableness), the following fact pattern is typical, and prejudicial to contractors:

1. Contractors are required to submit their annual incurred cost submissions within six months of the end of their fiscal year[50] after which the Auditor reviews the incurred cost submission for adequacy, including the supporting documentation, and resolves any adequacy issues, involving the CO as necessary.[51]
2. Once the incurred cost submission is determined to be adequate, the Auditor prepares an audit report to the CO, which will identify any questioned costs.[52]
3. Contractor is prejudiced when, years later, the CO adopts DCAA's findings and disallows all or a portion of the costs that the Auditor questioned. The disallowance is documented in a final decision that constitutes a government claim and is accompanied by a demand for payment for the disallowed costs.[53]

In recent years, DCAA has reported that it has improved the timeliness of its incurred cost audits.[54] Nevertheless, the government continues to pursue old cost disallowance claims against contractors.[55] Contractors thus have continuing exposure to tardy government cost challenges.

47. FAR 52.230-2(a)(5).
48. FAR 52.216-7.
49. *See* FAR subpart 42.8.
50. FAR 52.216-7(d)(2)(i); FAR 42.705-1(b); FAR 42.705-2(b).
51. FAR 42.705-1(b)(1)(iii)–(iv).
52. FAR 42.705-1(b)(1). These audits have been known to take years to complete.
53. FAR 33.211.
54. In response to significant DCAA audit delays, in its Fiscal Year 2018 National Defense Authorization Act, § 803(g)(3), Congress added a requirement that DCAA perform audits within one year of receipt of a qualified contractor incurred cost proposal. As of FY 2018, DCAA informed Congress it had eliminated its backlog of incurred cost audits. Def. Cont. Audit Agency, U.S. Dep't of Def., Report to Congress for Fiscal Year 2018 11 Activities (2019). In its most recent annual report, DCAA stated it has continued to comply with the congressional incurred cost audit one-year timeliness mandate. Def. Cont. Audit Agency, U.S. Dep't of Def., Report to Congress for Fiscal Year 2021 Activities (2022) [hereinafter DCAA 2021 Report].
55. *See, e.g.*, Doubleshot, Inc., ASBCA No. 61691, 22-1 BCA ¶ 38,169, at 185,371–75 (appeal of government claim disallowing costs based on missing timecards, among other issues, where the audit and government claim occurred seven to nine years after the contractor incurred the costs).

It bears mention that FAR 52.216-7, Allowable Cost and Payment, and FAR 52.230-2 (the CAS clause) do not generally prohibit retroactive disallowance of costs.[56] To the contrary, the cost principles[57] and CAS[58] contemplate that the government will challenge costs after the fact.[59] On the other hand, while the bar to retroactive disallowance is not founded on the CAS or the FAR, the ASBCA has also held that the regulations were not intended to, and did not, abrogate the rule.[60]

By their very nature, government claims based on CAS or FAR Part 31 will necessarily involve some measure of retroactivity. It is the contractor's obligation (and right) to develop its own cost accounting practices that conform to the government regulations, but it will necessarily take the government some reasonable time to audit, comment on or respond to those practices.[61] The rule against retroactive disallowance can only be invoked when the government's actions are *unreasonably* delayed or taken in circumstances that otherwise serve to mislead and prejudice the contractor and are therefore unfair.[62]

In summary, retroactive disallowance is a critical issue for those doing business with the government. Contractors' decisions regarding incurrence of costs under cost reimbursable contracts, and accounting for such costs, have a broader effect on their business operations. Contractors price their fixed price government contracts and commercial contracts using the same cost accounting practices and reasonably assume the cost decisions they made were correct. Contractors have no leeway to reprice their fixed price contracts when, years later, following a government audit or CAS compliance review, the government disallows the same category of costs under cost reimbursement

56. *See* FAR 52.216-7(g)(1)–(2), FAR 52.230-2.

57. The allowable cost and payment clause authorizes the government to perform audits "[a]t any time or times before final payment," and reduce payments based on disallowances or "adjust them for prior overpayments." FAR 52.216-7(g)(1)–(2). Similarly, the FAR provides for disallowance of costs after incurrence. FAR 42.803.

58. CAS-covered contracts include the clause at FAR 52.230-2 ("Cost Accounting Standards") requiring contractor to comply with a three-part obligation to (a) disclose its cost accounting practices, (b) follow those practices consistently, and (c) comply with the CAS in effect on the date of award. FAR 52.230-2(a)(1)–(3). The clause also includes the contractor's agreement to contract price/cost adjustments to meet compliance. FAR 52.230-2(a)(5). In the separate clause at FAR 52.230-6 ("Administration of Cost Accounting Standards"), the contractor further agrees to calculate the cost impact of a noncompliance consistent with FAR 52.230-6(i), which states, in relevant part: "The cost impact calculation shall include all affected CAS-covered contracts and subcontracts regardless of their status (i.e., open or closed) or fiscal year in which the costs are incurred (i.e., whether or not the final indirect rates have been established)." FAR 52.230-6(i). Thus, the two CAS clauses, taken together, clearly contemplate adjustments to any CAS-covered contracts affected by a noncompliance including those that were fully performed, or which affected overhead rates that were the subject of final rate agreements. FAR 52.230-6(f)(1). FAR 30.605 contains more detailed guidance on the processing of CAS noncompliances and also contemplates a repricing of contracts that were performed in the past. FAR 30.605.

59. *See* Data-Design Lab'ys, ASBCA No. 27245, 86-2 BCA ¶ 18,830, at 94,887 ("It is in the nature of cost type contracting, with contracts containing the standard [Allowable Cost and Payment] clause, that cost disallowances are retroactive.").

60. *Id.*

61. FAR 31.201-2(d).

62. *In re* Gen. Dynamics Corp., ASBCA No. 49372, 02-2 BCA ¶ 31,888, at 157,569–70.

contracts.[63] Retroactive cost disallowances thus have an acutely prejudicial effect on contractors. The costs effectively "disappear" from the accounting system and fall to the bottom line as reductions of earnings.

Retroactive disallowance is not only harmful to contractors but harms the government as well. The unjust practice undermines the government's ability to present itself as a fair and reliable business partner and drives competent companies away from the government marketplace. Indeed, the numbers of contractors participating in the defense market, including both small businesses and large businesses, have declined significantly in recent years:

> Overall, DOD awarded contracts to almost 25,000 fewer businesses in 2020 than it did in 2011, with the number of larger businesses contracting with DOD decreasing at a similar rate to small businesses. The number of larger businesses receiving contract awards fell by 7.3 percent per year on average from 2011–2020, while the number of small businesses receiving contract awards fell by 6 percent per year.[64]

Many government-unique requirements that may deter contractors from participating in the federal government market, such as cybersecurity or supply chain restrictions, are driven by national security concerns or public policy priorities. Not so with retroactive cost disallowance. The government attains no broader benefit, and serves no higher purpose, by reserving for itself the right to unfairly prejudice contractors by disapproving cost accounting practices or disallowing costs long after the fact.

The *TSI* majority justified its attempt to bring about the untimely demise of retroactive disallowance by suggesting it would encourage auditors to be more discriminating in questioning costs:

> [A] rule that would grant TSI relief here would encourage DCAA and COs to question as many costs as possible in early audits so as to "speak now or forever hold its peace." It is far better, we think, to encourage auditors to exercise judgment and discretion in determining the scope of their audits.[65]

If only the Board's encouragement had prompted greater judgment and discretion on the part of DCAA auditors. In 2021, the most recent year for which data are available, only 30.8% of costs DCAA questioned in incurred cost audits were sustained.[66] That is on par with the 28.6% sustained for FY 2017, the year *TSI* was decided.[67] In both cases, roughly 70% of contractor costs challenged by DCAA were ultimately allowed.[68]

63. *See* Falcon Rsch. & Dev. Co., ASBCA No. 19784, 77-2 BCA ¶ 12,795, at 59,481.

64. U.S. Gov't Accountability Off., GAO-22-104621, Small Business Contracting: Actions Needed to Implement and Monitor DOD's Small Business Strategy 9 (2021); *see also* Dep't of Def., State of Competition Within the Defense Industrial Base 1 (2022) (citing substantial declines in the numbers of suppliers in major weapons system categories and attendant concerns about potential declines in capabilities, capacity, and the level of competition for defense contracts).

65. Tech. Sys. Inc., ASBCA No. 59577, 17-1 BCA ¶ 36,631, at 178,388.

66. DCAA 2021 Report, *supra* note 54, at 7.

67. Def. Cont. Audit Agency, U.S. Dep't of Def., Report to Congress for Fiscal Year 2017 Activities (2018) [hereinafter DCAA 2017 Report].

68. DCAA 2021 Report, *supra* note 54, at 7; DCAA 2017 Report, *supra* note 67.

III. RELEVANT COURT AND BOARD PRECEDENT

A. The 1971 Court of Claims Decision in Litton Systems *Defined a Rule Against Retroactive Cost Disallowances Based on "Fairness" and Equitable Considerations*

As noted above, the Court in *Litton Systems* established a rule against unjustified retroactive disallowance.[69] Between 1959 and 1965, Litton allocated general and administrative (G&A) costs using a "cost of sales" base.[70] For fixed price contracts, Litton recognized cost of sales when the product was completed and sold, but in the case of cost type contracts it recognized a sale with each periodic request for partial payment.[71] The court affirmed the ASBCA ruling that this practice distorted the allocation of G&A cost to the detriment of Litton's government cost-type contracts.[72] In other words, the practice resulted in higher allocation of indirect costs to government cost-type contracts than is reasonable or appropriate. The issue remained, however, whether the resulting cost disallowance should be applied retroactively or only prospectively. Retroactive re-allocation would result in the permanent loss of $1.9 million ($14 million in 2023 dollars) that could no longer be reallocated to other contracts.[73]

Litton argued that, because the government had been aware of its practice for many years, the re-allocation

> would be unfair because it would cause approximately $1,900,000 of G&A expense which plaintiff had originally allocated to its [cost-plus-fixed-fee (CPFF)] contracts to be reallocated to its fixed price contracts, and that plaintiff would not be able to recover the reallocated amounts because its fixed price contracts have already been finally priced.[74]

Addressing this issue, the court made no reference to estoppel. Instead, it turned to the Armed Services Procurement Regulation (ASPR) equivalent of FAR Part 31, stating: "A proper construction of . . . the ASPR cost principles . . . requires that all of the relevant circumstances be examined in determining whether and to what extent, a change in a contractor's accounting practices should be retroactive."[75] Continuing, the court emphasized that no rigid litmus test applied, stating "[W]e think the cost principles require us to search for a result which … is 'fair and reasonable.' . . . Such a standard seems especially important here, where the Government seeks to retroactively impose upon plaintiff a new allocation method."[76]

The Court then recounted the parties' lengthy dealings on the issue, emphasizing that the government provided no "authoritative notice" of disapproval

69. Litton Sys., Inc. v. United States, 449 F.2d 392, 401 (Ct. Cl. 1971).
70. *Id.* at 393.
71. *Id.* at 397.
72. *Id.* at 392.
73. *Id.* at 399.
74. *Id.*
75. *Id.*
76. *Id.*

of the accounting practice until December 1962, when the Defense Contract Audit Agency (DCAA) issued the equivalent of a Form 1.[77] The Court of Claims concluded:

> 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. … Such notice was essential in order to enable plaintiff to recover the additional G&A expense that would be allocable to its fixed price contracts as a result of the shift in accounting methods.[78]

The Court never used the word "estoppel," and it is difficult to avoid the conclusion that this was intentional. The *Litton* rule barred the disallowance only *retroactively*.[79] The court found the accounting practice to have been improper, and the disallowance was effective from the date of "authoritative notice."[80]

B. Board Decisions Following Litton *Barred Retroactive Disallowance on the Basis of Fair and Reasonable Treatment, Without Reference to Estoppel*

Beginning in 1971 and for decades thereafter, Board decisions barring retroactive cost disallowances followed *Litton*, basing their holdings on the ASPR, DAR, and FAR cost principles requiring fair and reasonable treatment of contractors in cost-related matters. *Sanders Associates, Inc.* involved a disagreement as to whether a company-wide overhead rate was appropriate, resulting in a disallowance of overhead cost retroactive to 1967 and 1968.[81] Sanders agreed with the change to business unit overhead rates when applied prospectively but challenged the retroactive application of the new rates "since that action would deprive appellant of the opportunity of pricing the products of . . . [the business unit involved] on the basis of an accurate knowledge of the costs of the products being sold."[82] Following *Litton*, the Board held that

> the criterion should be whether under the circumstances the contractor reasonably believed that the Government would allow it to continue to include the expenses of Data Systems in its company-wide overhead pools and acted on that belief to its detriment . . . . Under the circumstances, appellant was entitled to actual prior notice that the Government no longer would approve such inclusion. . . .[83]

Nowhere did the Board use the word "estoppel" or refer to its elements.

Sanders was followed by *Falcon Research and Development Co.* in which the government sought to disallow a portion of 1970–1972 overhead, alleging that a home office allocation included in overhead was in fact an "interest"

77. *Id.* at 400–01. A DCAA Form 1 gives notice to a contractor that DCAA has suspended or disapproved certain contractor costs.
78. *Litton Sys., Inc.*, 449 F.2d at 401.
79. *See id.*
80. *Id.*
81. Sanders Assoc., Inc., ASBCA No. 15518, 73-2 BCA ¶ 10,055, at 47,164–65.
82. *Id.* at 47,163.
83. *Id.* at 47,163, 47,165.

charge. [84] During the period in question, the government awarded Falcon numerous fixed price contracts that Falcon priced on the basis of the unchallenged home office allocation.[85] In 1974, DCAA issued a Form 1 disallowance of the charges retroactive to the earlier years.[86] The Board rejected the retroactive component of the disallowance, relying on the "concept of fairness and equity" expressed in *Litton* and without using the word "estoppel":

> The rule is founded on concepts of fairness and equity. One of its more frequent applications is in situations—such as occurred here—where a contractor with Government approval has spread its overhead costs over all contracts, cost reimbursement and fixed price, with the result that any amounts disallowed retroactively under the cost-type contracts would be non-recoverable under the fixed-price type because the latter could not be reopened. [87]

The Board noted that, even where the contractor's position is erroneous, the "retroactive disallowance" rule would still apply: "This principle applies even in circumstances where the claimed overhead cost, viewed *ab initio*, would be unallowable under the applicable contract cost principles."[88]

On reconsideration, the government argued the contractor had failed to satisfy the elements required to establish estoppel.[89] The Board responded that it did not base its decision on estoppel, confirming the independent basis of the finality rule in *Litton*: "[T]he respondent dealt with the concept of estoppel in its brief at considerable length, arguing that all the elements of estoppel were not present in the case. *Indeed, the Board's decision was not based on the concept of estoppel*."[90]

Data-Design Laboratories involved a disallowance of certain travel costs applied retroactively to 1973. [91] The contractor allocated the costs on both a direct and indirect basis depending on the nature of the travel involved.[92] Only in 1975 did DCAA issue a Form 1 disallowance.[93] The Board upheld the government's interpretation of the applicable cost principle but followed *Litton* in denying retroactive disallowance.[94] The Board rejected the government's argument that the Allowable Cost and Payment clause[95] "permits the retroactive disallowance of costs even where a contractor has relied upon the government's prior approval of the costs to its detriment."[96]

84. Falcon Rsch & Dev. Co., ASBCA No. 19784, 77-2 BCA ¶ 12, at 59,481, *reconsideration denied*, 77-2 BCA ¶ 12,795.
85. *Id.* at 59,483.
86. *Id.*
87. *Id.* at 59,484. In addition to relying on the "fairness and equity" rationale, the Board cited a related "joint interpretation" rule under which "a practical contemporaneous interpretation or construction by the parties is entitled to great, if not controlling, weight in resolving the dispute which subsequently arose …." *Id.* at 59,484–485.
88. *Id.* at 59,484.
89. *See Falcon Rsch & Dev. Co.*, 77-2 BCA ¶ 12, at 62,249.
90. *Id.* at 62,249 (emphasis added).
91. Data-Design Laboratories, ASBCA No. 21029, 81-2 BCA ¶ 15,190, at 75,169, *aff'd on recons.* 82-2 BCA ¶ 15,932.
92. *Id.*
93. *Id.* at 75,166–169.
94. *Id.*
95. FAR 52.216-7.
96. *Data-Design Lab'ys*, 81-2 BCA ¶ 15,190, at 75,174.

C. In Gould Defense Systems *the Board Applied the* Litton *Rule but Unnecessarily Added Discussion of Estoppel*

In *Gould Defense Systems, Inc.*, the government successfully argued Gould's inclusion of goodwill in facilities capital was noncompliant with CAS 414.[97] However, the Board further held the government could not apply the exclusion retroactively.[98] In raising the retroactive disallowance defense, Gould mistakenly used the language of estoppel.[99] The Board also referred to estoppel, but then turned to "retroactive disallowance," referring to it as a "related precept":

> This rule [estoppel] is to be compared with the related precept that the Government may not disallow retroactively historical costs where: the cost or accounting method in question previously had been accepted following final audit of historical costs; the contractor reasonably believed that it would continue to be approved; and it detrimentally relied on the prior acceptance [citing *Data Design*]. The retroactive disallowance rule applies regardless of the allowability of the historical cost . . . and requires that the Government only may disallow the cost or method prospectively.[100]

The Board's invocation of the retroactive disallowance rule was sufficient to support its ruling, but it nevertheless characterized the retroactive disallowance rule as a "special application" of estoppel principles: "Whereas invocation of the retroactive disallowance rule has been premised on the contractor's reliance on final historical cost audits, the rule, nevertheless, is a special application of estoppel principles."[101] The Board misstated the bounds of the retroactive disallowance rule, incorrectly limiting the rule to "final historical cost audits," contrary to the prior decisions.[102] This misconception may have prompted the Board to include its discussion of estoppel: "The general rules governing application of the doctrine of equitable estoppel in cost disputes are not limited necessarily to situations where the cost or accounting method in question has been accepted [previously by the Government] following final audit."[103]

Alone among retroactive disallowance decisions, *Gould* applied the four-part test for equitable estoppel to analyze whether the disallowance was barred.[104] Because the facts in *Gould* made out a straightforward case of retroactive disallowance, however, the Board's references to estoppel were *obiter dictum*—not relevant to the holding.

97. Gould Def. Sys., Inc., ASBCA No. 24881, 83-2 BCA ¶ 16,676, at 82,975–84.
98. *Id.*
99. *Id.* at 82,981 ("[W]e must now address the alternative argument that the Government is estopped . . . .").
100. *Id.*
101. *Id.* at 82,981. The Board also cited for support the "joint interpretation" argument addressed in *Falcon Research*. *Id.* at 82,984.
102. *See Falcon Rsch. & Dev. Co.*, 77-2 BCA ¶ 12,795 (reliance on interim billings); *Data Design Lab'ys*, 81-2 BCA ¶ 15,190, at 75,169, *aff'd on recons.*, 82-2 BCA ¶ 15,932 (meetings with the government); Litton Systems, Inc. v. United States, 449 F.2d 392, 401 (Ct. Cl. 1971) (provisional rates, cost reimbursement interim billings).
103. *Gould Def. Sys., Inc.*, 83-2 BCA ¶ 16,676, at 82,928.
104. *Id.* at 82,981.

The bright feature of *Gould* is that it reinforced the vitality of the rule against retroactive disallowance and confirmed that the rule can apply in the context of CAS noncompliance. This ruling is significant because *Litton* addressed cost accounting for contracts during the period 1959–1965, before the CAS came into being in the 1970s.[105] The CAS clauses make clear that noncompliances have retroactive effect.[106] *Gould* demonstrates that, even though cost adjustments may otherwise be required for past CAS noncompliances, where the government has knowingly approved the contractor's cost accounting practices and the contractor reasonably relied on such approval, the government is barred from retroactively disallowing the associated costs. Significantly, the Board stated:

> The fact that the contract contained the Cost Accounting Standards clause and that interpretations of Cost Accounting Standards are involved do not warrant a different result. The contractor's reliance was not rendered unreasonable by the presence of the CAS clause in appellant's contract and the purported "notice" of a potential disallowance should it be found not to be in compliance with a cost accounting standard. There is no relevant distinction to be made in this regard between the CAS clause and the results reached under the "Allowable Costs, Fee and Payment" clause.[107]

D. Lockheed Martin WDL *in 2002 Affirmed the Continuing Vitality of the Bar to "Retroactive Disallowance"*

In March 2002, the ASBCA issued its decision in *Lockheed Martin Western Development Laboratories (WDL)*, involving attempted disallowance of a long-standing policy for the payment of "settling in allowance" (SIA) to employees transferred overseas. [108] The Board ruled that the cost was unallowable under FAR Part 31.[109] However, citing *Litton*, *Sanders*, and *Data-Design*, the Board also held that the government had "raised no objections" to the cost between 1984 and 1991, although it had never conducted an audit: "We therefore conclude that WDL did not receive adequate and authoritative notice that the Government would no longer allow SIA equal to one month's base salary until it received DCAA's CAS 405 non-compliance audit sometime in July 1994." [110]

Thus, the rule against retroactive disallowance was in full force and effect and applied to cases involving both cost disallowances under FAR Part 31 and CAS noncompliance claims.

105. *Litton*, 449 F.2d at 393.

106. *See* FAR 30.605(h)(1) (instructing that cost impacts of CAS noncompliances should be calculated to "[i]nclude all affected CAS-covered contracts and subcontracts regardless of their status (i.e., open or closed) or the fiscal year in which the costs are incurred (i.e., whether or not the final indirect cost rates have been established)").

107. *Gould Def. Sys., Inc.*, 83-2 BCA ¶ 16,676, at 82,983.

108. Lockheed Martin W. Dev. Lab'ys (WDL), ASBCA No. 51452, 02-2 BCA ¶ 31,803, at 157,102–04.

109. *Id.*

110. *Id.* at 157,104.

E. Rumsfeld v. United Technologies *Sharply Limited Equitable Estoppel Against the Government, but Did Not Address the Rule Against Retroactive Disallowance*

Rumsfeld v. United Technologies Corp. (*UT*) involved the issue of what constitutes a "cost" for purpose of inclusion in the base for allocation of overhead.[111] The ASBCA adopted the contractor's definition of cost, and the Federal Circuit vacated and remanded, leaving the issue of whether the ruling should be applied retroactively.[112] The Federal Circuit noted that *UT* had raised a "lengthy estoppel defense" and addressed that issue in summary fashion, without addressing the retroactive disallowance rule.[113] Specifically, the Federal Circuit added a new element of proof required to establish estoppel against the government in the government contract context—whether or not the government's actions amounted to "affirmative misconduct."[114]

Most significantly, the Federal Circuit in *UT* did not cite *Litton* or refer to the *Litton* rule. As announced by the Federal Circuit in 1982, only the Federal Circuit sitting *en banc* may overturn an established precedent of the Court of Claims.[115] The result was that *Litton* and *UT* may stand side-by-side and be read together, neither decision conflicting with the other.[116]

111. Rumsfeld v. United Techs. Corp., 315 F.3d 1361, 1363 (Fed. Cir. 2003).
112. *Id.*
113. *Id.* at 1368.
114. *Id.*
115. Decisions of the former Court of Claims are of equal standing with decisions of the Federal Circuit. *South Corp. v. United States* notes:

> As a foundation for decision in this and subsequent cases in this court, we deem it fitting, necessary, and proper to adopt an established body of law as precedent. That body of law represented by the holdings of the Court of Claims and the Court of Customs and Patent Appeals announced before the close of business on September 30, 1982 is most applicable to the areas of law within the substantive jurisdiction of this new court. It is also most familiar to members of the bar. Accordingly, that body of law is herewith adopted by this court sitting in banc.

South Corp. v. United States, 690 F.2d 1368, 1370 (Fed. Cir. 1982) (en banc). In a footnote, the Court added:

> The present adoption does not affect the power of this court, sitting in banc, to overrule an earlier holding with appropriate explication of the factors compelling removal of that holding as precedent. If conflict appears among precedents, in any field of law, it may be resolved by the court in banc in an appropriate case.

Id. at 1370 n.2. *South Corp.* is still commonly cited for the binding authority of Court of Claims decisions. *See*, *e.g.*, Slattery v. United States, 635 F.3d 1298, 1300 n.1 (Fed. Cir. 2011); Randa/Madison Joint Venture III v. Dahlberg, 239 F.3d 1264, 1269 (Fed. Cir. 2001); Pub. Warehousing Co., K.S.C., ASBCA No. 58088, 17-1 BCA ¶ 36,589, at 178,208 n.2. In 1971, when the *Litton* decision was issued, the Court of Claims decided all cases *en banc*. It is thus even less appropriate to conclude that a panel of the Federal Circuit could overturn a Court of Claims decision.

116. Pratt filed a petition for rehearing or rehearing *en banc*, and then a petition for a writ of certiorari, which were denied by the Federal Circuit (Rumsfeld v. United Techs. Corp., No. 02-1071, 2003 U.S. App. Lexis 9624, at *1 (Fed. Cir. Apr. 23 2003)), and the Supreme Court (United Techs Corp. v. Rumsfeld, 540 U.S. 1012 (2003)), respectively. The denials had no

Two years after *UT*, the Federal Circuit issued a decision in *United Pacific Insurance*, a government contracts case that did not involve accounting issues, again holding that affirmative misconduct was required to assert equitable estoppel against the government.[117] At issue was whether the government was estopped from denying an incorrect contract balance listed in a "whereas" clause of a takeover agreement between the government and a surety to complete performance of a construction contract following a default termination.[118] The Federal Circuit affirmed the ASBCA, holding that the surety could not assert equitable estoppel against the government because affirmative misconduct was required and the incorrect recital "was the result of unintentional mathematical errors, not affirmative misconduct."[119] The decision was arguably the final nail in the coffin for the contractor's estoppel defense, but it had no bearing on the *Litton* rule against retroactive disallowance–and, like *UT*, could not have because it was a panel decision.

F. The ASBCA on Remand Held That UT *Had Failed to Meet the Test of* Litton

On remand from the Circuit, UT raised the retroactive disallowance defense. The ASBCA addressed the rule in *Litton*[120] and held it to be inapplicable since *UT* had failed to establish either that the government was aware of the accounting practice at issue, or that *UT* had relied on the government's acquiescence over time.[121]

The Board proceeded, however, to treat retroactive disallowance as a form of estoppel against the government, relying on the anomalous language in *Gould*,[122] and suggested affirmative misconduct was required (and absent): "We . . . will follow the guidance provided by the CAFC in deciding the estoppel issue in these appeals and require that appellant demonstrate some form of affirmative misconduct by the government . . . ."[123]

The ASBCA's comments regarding the affirmative misconduct requirement were inconsistent with *Litton* and with the Board's own precedent, which firmly recognized retroactive disallowance as a distinct rule independent of estoppel. In any event, because necessary elements of retroactive disallowance were not present, the Board's views regarding whether affirmative misconduct is required under the retroactive disallowance rule were dicta.

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precedential value. *See* Exxon Chem. Patents, Inc. v. Lubrizol Corp., 137 F.3d 1475, 1479 (Fed. Cir. 1998); Singleton v. Comm'r, 439 U.S. 940, 944 (1978).

117. United Pac. Ins. Co. v. Roche, 401 F.3d 1362, 1366 (Fed. Cir. 2005).

118. *Id.*

119. *Id.* at 1366.

120. United Techs. Corp., Pratt & Whitney, ASBCA Nos. 54512 *et al.*, 06-1 BCA ¶ 33,289, at 165,032–33 (on remand).

121. *Id.* at 165,054.

122. "We have previously described the *Litton* retroactive disallowance rule as 'a special application of estoppel principles.'" *Id.* at 165,050 (*citing* Gould Def. Sys., Inc., ASBCA No. 24881, 83-2 BCA ¶ 16,676, at 82,981).

123. *Id.* at 165,058.

G. *The ASBCA's 2017 Decision in* Technology Systems, Inc. *Erroneously Declared* Litton *No Longer to Be Law*

In January 2017, the ASBCA issued an opinion in *Technology Systems, Inc.* (*TSI*).[124] The decision was unusual as the judge who heard the appeal and prepared a recommended opinion sustaining the appeal (Judge Clarke) failed to persuade his colleagues who instead issued an opinion denying the appeal and relegating Judge Clarke's opinion to a dissent.[125] Both the Board opinion and the dissent mistakenly focused on *UT*'s impact on the *Litton* rule, but neither acknowledged that a panel of the Federal Circuit could not overturn a Court of Claims precedent, and both failed to recognize that the Board was still subject to the *Litton* precedent, which (as stated above) the Federal Circuit sitting *en banc* had not overturned.[126] Perhaps most importantly, the case did not present facts permitting the Board to invoke the *Litton* rule.[127] Thus, the Board's sweeping announcement that the *Litton* rule was no more was (1) dicta, (2) unsupported by *UT*, and (3) clearly erroneous.[128]

At issue in *TSI* were the contractor's indirect costs for 2007.[129] TSI submitted its final 2007 indirect costs in 2008 and DCAA initiated an audit, only to suspend it shortly thereafter. [130] DCAA did not resume the audit until 2013, and then questioned a number of costs. The CO held discussions with TSI regarding those costs until June 2014 when he issued a final decision disallowing the costs.[131] TSI challenged that decision before the Board, claiming that DCAA had not questioned any of its indirect costs for the years 2002 through 2006 and changed its position with respect to the 2007 costs.[132] However, TSI did not assert facts necessary to invoke the "retroactive disallowance" doctrine; namely, that DCAA had specifically approved any particular cost prior to 2007 and later reversed position.[133] Moreover, some of the costs incurred in 2007 had not been incurred in earlier years.[134] In sum, the facts necessary to support a *Litton* bar to retroactive disallowance were not present. Thus, the appeal should have failed on this ground alone:

> [W]e would . . . find, on the facts before us, that retroactive disallowance is inapplicable to this appeal. The government's failure to challenge TSI's costs in prior audits (without more) was not enough to give TSI the reasonable belief that such costs would never be challenged in the future.[135]

124. Tech. Sys., Inc., ASBCA No. 59577, 17-1 BCA ¶ 36,631, at 178,375.
125. *Id.* at 178,377.
126. *See id.*
127. *Id.* at 178,387.
128. *Id.*
129. *Id.* at 178,394–95 (Clarke, J., dissenting).
130. *Id.* (TSI was a small business with four Navy cost-plus-fixed-fee contracts, apparently no longer in business as of the time of the hearing.).
131. *Id.* at 178,379–80.
132. *Id.* at 178,378–80.
133. *Id.* at 178,387.
134. *Id.* at 178,382–83.
135. *Id.* at 178,387.

For this reason, there was no need for the Board to address the impact of estoppel law on the rule in *Litton*. Indeed, the Board noted that "[r]etroactive disallowance was not briefed by the parties . . . [yet] we need not seek further briefing upon it because we find the law to have changed to make it an unsustainable theory. . . ."[136] The Board then unfortunately announced: "Retroactive disallowance is a theory for challenging audits whose heyday has come and gone."[137]

To justify this conclusion, the Board in *TSI* tried to establish a link between estoppel and the non-retroactivity rule of *Litton* by invoking the detour in *Gould* that retroactive disallowance is a "special application of estoppel principles," while disregarding the prior decisions cited above, including *Litton* itself, attesting that the *Litton* rule is separate and distinct from estoppel because it does not seek to bind the parties beyond the date of "authoritative notice."[138] Nevertheless, the Board believed *Gould* provided an opening to justify the grafting of *UT*'s "affirmative misconduct" holding onto the *Litton* rule, running it aground: "Being a 'special application of estoppel principles,' . . . retroactive disallowance is thus now subject to the same affirmative misconduct requirement as other estoppel defenses."[139]

The Board's principal mistake was its assertion that retroactive disallowance is "a special application of estoppel principles."[140] As noted earlier, nowhere in *UT* did the Circuit cite *Litton*, with the necessary result that *Litton* was unaffected by the *UT* ruling. Moreover, the Board blurred the distinction between estoppel and retroactive disallowance, suggesting incorrectly that the *UT* court "characterized the retroactive disallowance argument . . . as being that the 'government [was] estopped from contesting' the accounting determination at issue."[141] Since the *UT* court never mentioned the rule in *Litton*, it did no such thing.[142] Even worse, the Board went on to assert that: "[T]he Federal Circuit instructed us that 'affirmative misconduct' on the part of the government would be required for the application of the principle."[143]

Here, the Board mistakenly assumed that "the principle" referred to was retroactive disallowance. The court in *UT* never addressed *Litton* and retroactive disallowance. The "principle" the court referred to in *UT* was estoppel and estoppel alone.

H. Technology Systems *Is Inconsistent with Other Decisions Following the Circuit Holding in* UT

Finally, the decision in *Technology Systems* does not square with other decisions following *UT*. *Raytheon Co.* involved government claims that certain

136. *Id.* at 178,386.
137. *Id.*
138. *Id.*
139. *Id.* at 178,387 (quoting Gould Def. Sys., Inc., ASBCA No. 24881, 83-2 BCA ¶ 16,676, at 82,981).
140. *Id.*
141. *Id.* (quoting Rumsfeld v. United Tech. Corp., 315 F.3d 1361, 1377 (Fed. Cir. 2003)).
142. *See id.*
143. *Id.*

incentive compensation costs were unallowable.[144] The Board held that one component of the costs was unallowable because it was based in part on changes in the price of securities.[145] In response to Raytheon's defense of retroactive disallowance, the Board stated:

> The . . . principle is commonly known as the "retroactive disallowance" principle. The government does not dispute the principle, but contends that it has no bearing on the government's monetary claims under the facts of record. . . . [I]ts application is largely fact dependent. In these appeals, there are material factual disputes of record that need to be addressed to determine whether this principle is applicable here, including but not limited to, whether or not the government with knowledge, consistently approved the subject . . . costs; and, if so, when the government first put appellant on reasonable notice that said costs were unallowable. [146]

This is a correct application of the "retroactive disallowance" principle.[147]

The Court of Federal Claims (COFC) issued a similar decision in *City Crescent Limited Partnership v. United States*.[148] There, the government had paid real estate taxes under a lease for seven years.[149] Then, after negotiating a lease renewal, it changed position and adopted a new interpretation of the relevant tax adjustment clause:[150]

> The circumstances here are akin to those in *Litton Systems, Inc.* . . . In *Litton*, the Government changed an accounting method in mid-performance of a number of existing contracts. The contractor had relied on the "long and consistent use" of the former accounting method which had been employed "with the Government's knowledge, approval and acquiescence. . . ." Defendant is bound by its interpretation of the Tax Adjustment clause relied upon by Plaintiff in the negotiation of the 15-year lease renewal.[151]

Thus, contrary to the Board's suggestion in *TSI*, the Court of Federal Claims has held that the "retroactive disallowance" rule remains in effect after *UT* and has correctly applied the rule.

I. The COFC 2022 Sikorsky *Decision, Without Addressing Estoppel or the Rule in* Litton, *Reflects the Court's Continued Concern with Unfair Retroactive Disallowances*

Most recently, the COFC's decision in *Sikorsky Aircraft Corp. v. United States* on motions to dismiss evidences the continuing discomfort of the courts and boards with unfair retroactive disallowances.[152] *Sikorsky* described its accounting practice for IR&D and bid and proposal (B&P) costs in a Disclosure

144. Raytheon Co., ASBCA No. 57576, 15-1 BCA ¶ 36,043, at 176,041.
145. *Id.* at 176,055; FAR 31.205-6(i).
146. *Raytheon Co.*, 15-1 BCA ¶ 36,043, at 176,055.
147. The majority in *TSI* mentioned that Raytheon "did not discuss the requirement of affirmative misconduct," but disregarded this omission on the basis that it did not purport to overrule the Board's *UT* remand decision, or the Federal Circuit's *UT* decision. *Tech. Sys., Inc.*, 17-1 BCA ¶ 36,631, at 178,387.
148. *See* City Crescent Ltd. P'ship v. United States, 71 Fed. Cl. 797, 798 (2006).
149. *Id.* at 798, 806.
150. *Id.*
151. *Id.*
152. *See* Sikorsky Aircraft Corp. v. United States, 161 Fed. Cl. 314, 324 (2022).

Statement filed on or before 2007 that the contracting officer found to be "adequate" but as to which neither the contracting officer nor DCAA had conducted a review for "compliance."[153] Meanwhile, Sikorsky continued pricing contracts and applying indirect rates based on a forward pricing rate agreement (FPRA) that in turn was based on the disclosed IR&D and B&P practices.[154]

Five years after the Disclosure Statement "adequacy" determination, DCAA issued a determination of "areas of non-compliance with CAS 420" but took no further action.[155] In 2014, DCAA issued an audit report asserting misallocation of the IR&D and B&P costs and issued a notice of potential noncompliance, but again no action was taken.[156] Only in December 2020 did the CO issue a final decision demanding what must be assumed to be a large dollar figure.[157]

Sikorsky brought suit in the COFC asserting breach of contract, claiming that its accounting practices had been accepted and asserting the right to a declaratory judgment that its accounting practices for IR&D and B&P were compliant.[158] The government filed a motion to dismiss, essentially challenging any contractor argument that would "preclude the government's revocation of accepted cost accounting practices."[159]

Without mentioning the words "estoppel" or *Litton*, the court rejected on a number of grounds the government's sweeping assertion of its right to challenge compliance of CAS Disclosure Statements at any time and for an unlimited time.[160] First, the court summarized Sikorsky's claim that "the government continued to enter into contracts based on Sikorsky's alleged noncompliant practices without notifying Sikorsky of any concerns, which it argues should in turn represent a determination of compliance," essentially a "joint interpretation" argument. [161] The court found the defense potentially viable, holding that the record "does not provide a basis to dismiss the controverted [claim]."[162] Next the court referred to the government's asserted ability "to issue compliance determinations years after entering into contracts or even after a notice of potential noncompliance," citing the government's duty of good faith and fair dealing, and then stated: "The connection between the government's duty to act in good faith by not allowing Sikorsky to incur costs

153. FAR 30.202-6(b) barred the government from awarding a CAS covered contract before an "adequacy" determination was made. FAR 30.202-6(b). FAR 30.202-7(b)(1)(i) in turn required the government to institute a "compliance" examination once an adequacy finding was made but did not further bar award of new contracts. FAR 30.202-7(b)(1)(i).

154. *Sikorsky*, 161 Fed. Cl. at 318–19.

155. *Id.* at 319.

156. *Id.* at 319–20.

157. *Id.* at 319. (The amount demanded was redacted.)

158. *Id.*

159. *Id.*

160. *Id.* at 320. Of course, the CDA six-year limitations period would come into play at some point. *Id.*

161. *Id.* at 322.

162. *Id.*

it would later be expected to bear alone and Sikorsky's regulatory and contractual obligation to accept changes is not evident at this stage."[163]

The idea of breach of the duty of good faith appears to be a new entrant in the debate over remedies for retroactive disallowances. Certainly, establishing breach of contract does not require proof of affirmative misconduct, and the court seems to suggest that passage of time and benign neglect may be sufficient to establish a breach.[164] Finally, in a footnote, the court added a catch-all suggestion: "Whether the government's action in this case by entering into a FPRA [Forward Pricing Rate Agreement] and entering into contracts based on the same practices it now claims are noncompliant constitutes a waiver or otherwise obligated the government in some fashion remains to be seen."[165]

In sum, *Sikorsky* confirms that the courts and boards remain sensitive to the lack of fairness in retroactive CAS and other cost disallowances where irrevocable pricing decisions over time, and under the illusion of compliance, suddenly become imprudent without any hope of correction. This hopeful sign offers reason to believe the Boards and courts will disregard the premature obituary for *Litton* offered by the ASBCA in *Technology Systems*.

IV. CONCLUSION

Retroactive disallowance of contract costs is inherently unfair. Its frequent recurrence has troubled the Boards and courts. The Court of Claims in *Litton* enunciated a simple rule based on fairness in contract dealings. Since this rule only barred disallowances of incurred costs up to a point of "authoritative notice," unlike estoppel, which may have binding effect into the future, the *Litton* court was careful to distinguish the rule it announced from estoppel. The Federal Circuit, successor to the Court of Claims, has not overruled *Litton*.

Simply stated, the rule against retroactive disallowance is not a subset of estoppel and should not be confused with estoppel. Nevertheless, the Federal Circuit's 2003 *UT* decision introducing an "affirmative misconduct" requirement into estoppel led to confusion whether this change somehow affected the *Litton* rule. This state of confusion prompted the ASBCA in 2017 to announce improvidently in *Technology Systems* that *Litton* no longer applied, adding to the muddled state of the case law. Careful analysis of *Technology Systems* and other relevant decisions since 2003 confirms that *Litton* remains binding precedent in the Federal Circuit and that the *Litton* rule against retroactive disallowance is alive and well.

163. *Id.*

164. It is possible to argue that the *Litton* rule itself is based on notions of breach of the implied duty of fairness and cooperation.

165. *Id.* at 322 n.11.