On June 26, 2013, the Federal Acquisition Regulation Cost Principle on the allowability of compensation costs (31.205-6) was revised. It was revised via **an interim rule** . Concurrently, the FAR Council also published a *proposed rule* that would revise it even more. And what's worse, the Cost Principle revision in the interim rule is to be applied retroactively to costs incurred (or allocated) to contracts awarded in CY 2012—and the revision was published literally less than a week before contractors' CY 2012 annual proposals to establish final billing rates were due. And what's even worse than *that* is that the proposed rule would also apply retroactively as well—but to a different time period.

What's a good contractor to do?

Let's first discuss the interim rule, which is complicated enough all by itself. The rule became effective on June 26, 2013—literally four calendar days before contractors with a 12/31/2012 fiscal year-end would have been required to finalize and submit their annual proposals to establish final billing rates (aka, "incurred cost submissions"). Does the interim rule apply to costs incurred in those contractors' fiscal 2012? Yes, it does. Perhaps. It applies to some contracts, but not to others.

Did we mention this rule was complex?

Let's clarify the rule's requirements:

- For DOD, NASA and Coast Guard contracts awarded after December 31, 2011, the current executive compensation cap is to be applied to *all contractor employees*, not just the Top Five most highly compensated executives at each segment.

- For contracts awarded by other Executive Branch agencies, the current executive compensation cap is to be applied only to the Top Five most highly compensated executives

at each segment.

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The Allowable Cost and Payment Clause (52.216-7) has been modified and now provides a link to a good history of the compensation benchmark. Here is **that link** .

The timing of the publication was unfortunate, to say the least. We would assert that there would be no way that a contractor of more than medium size could actually implement the rule in the timeframe provided. And notice that the rule was *retroactive*, applying to contract costs incurred prior to its publication.

The interim rule, as published, requires contractors with contracts from multiple agencies to establish at least three sets of indirect cost rates to be applied to their 2012 contract costs. The first set is for contracts awarded prior to 12/31/2011. The new rule does not apply to those contracts, regardless of awarding agency. The second set is for DOD/NASA/Coast Guard contracts awarded after 12/31/2011, to which the compensation ceiling is to be applied to labor costs directly charged to those contracts. (There is some question in our minds as to whether the ceiling should be—*or could be*—applied to indirect labor that is allocated to such contracts, especially G&A labor.) The third set of rates is for contracts awarded after 12/31/2011 by Executive Branch agencies other than DOD, NASA, or the Coast Guard. Those rates will default back to the old rule.

And contractors needed to figure this out in four calendar days, most of which were weekend days.

In reality, we suspect most contractors will ignore the new rule's 2012 application requirements and apply it to their FY 2013 costs. They will argue—with much support and legal precedent—that the rule is retroactive as written, and that the only cost allowability rules with which they need to comply are the ones that were in effect at the time the contract was executed. We suspect they'll point out that an attempt to retroactively enforce cost allowability rules is, technically, a breach of contract.

The FAR Councils acknowledged as much, writing—

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)).

We further suspect that, regardless of the merits of that line of argument, DCAA won't buy it. The audit agency's reaction may take the form of a rejection (inadequacy) or it may take the form of additional questioned costs. Consequently, contractors need to prepare for DCAA's reaction and plan their next steps.

Now, on to the **proposed rule** .

The proposed rule addresses the retroactive application of the compensation caps to DOD/NASA/Coast Guard contracts awarded *before* December 31, 2011. Labor costs incurred after January 1, 2012 on those contracts would be subject to the compensation ceiling. Thus, the retroactive implementation of the compensation ceiling would be extended back even further than the interim rule would have it be.

We don't know what Congress was thinking. But you can tell the FAR Councils what you think

about either the interim or the proposed rule by submitting your comments. Details regarding how to submit comments on each of the rules can be found in the Federal Register notices—links above.