

## Excessive Pension Plan Contributions?

Written by Nick Sanders

Tuesday, 03 October 2023 08:47 -

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I used to joke that, at many aerospace/defense contractors, employees are not actually the most important priority. Instead, the supplement executive retirement plan is the most important priority. It was a joke, folks.

But then Northrop Grumman started to litigate government disallowances of its pension plan contributions.

The [Northrop Grumman Supplemental Executive Retirement] Pension Plans are designed to provide supplemental retirement benefits, paid after retirement, to a select group of Northrop Grumman's executives and other key employees or highly compensated employees whose retirement benefits exceed those permitted under Northrop Grumman's qualified pension plans, to encourage these employees to continue providing services to Northrop Grumman until their retirement.

(Internal citations and footnotes omitted.)

How does Northrop Grumman calculate the executives' supplemental retirement plan benefits? Well, it varies (because there are a number of plans)—but one factor that crosses all plans is the participants' Final Average Earnings (FAE). The plan calculates the FAE for each individual, then applies a percentage factor to that FAE to calculate the pension plan contribution amount. The number of years of service is also factored-in, but that's not especially relevant to this discussion.

Critically, when calculating the FAE, "The FAE does not exclude compensation that was in excess of the FAR 31.205-6(p) compensation limitation in effect at the time the plan participant earned the compensation (bonus and salary)." Thus, the FAE *includes* compensation made unallowable by 31.205-6(p).

The amount of the participants' supplement executive retirement plan benefits is based, at least in part, on unallowable compensation.

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Is this a concern? Northrop Grumman didn't think so. The company argued that—

... the pension costs here are allowable pursuant to FAR 31.205-6(j)(1) as they meet both CAS 412 and 413, which are referenced in that FAR provision, and that 'the cost limitations and exclusions set forth in paragraph (j)(1)(i) and in paragraphs (j)(2) through (j)(6)' do not apply to the pension costs at issue here. According to appellant, the compensation cap set forth in FAR 31.205-6(p) has no application because (1) it does not expressly state that it applies to defined benefit pension plans, and (2) FAR 31.205-6(p)(2)(ii) states the cap represents 'the 'sole statutory limitation' on allowable senior executive . . . compensation'. Appellant also argues that the pension costs are not directly associated costs under FAR 31.201-6(a) because the pension costs were not 'generated solely' as a result of unallowable compensation (salary and bonus) and the government cannot establish that the pension costs would not have been incurred but for the incurrence of the participant's compensation.

(Internal citations omitted.)

The government, for its part, begged to differ with Northrop Grumman, which is why the matter wound up before [the ASBCA](#) .

As summarized by the Board, the government's position was—

... although the Pension Costs themselves may not be subject to the FAR 31.205-6(p) compensation cap, the cap nonetheless applies to the underlying bonus and salary utilized in the Retirement Benefit Formulas' compensation factor. The government notes that FAR 31.205-6(p)(2)(ii) expressly disallowed senior executive compensation in excess of the benchmark compensation amount determined applicable for the contractor fiscal year by the Administrator of the Office of Federal Procurement Policy (OFPP). According to the government, the pension costs here are unallowable as directly associated costs of unallowable compensation pursuant to FAR 31.201-6 and are unreasonable because they are derived from unallowable compensation. The linchpin connecting both arguments is the proposition that the Retirement Benefit Formulas utilized to determine pension costs include as one factor a plan participant's FAE computed utilizing compensation that exceeded the FAR 31.205-6(p) limitation in effect at the time the plan participant earned the compensation.

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(Internal quotations and citations omitted.)

Northrop's arguments were unavailing. The Board ruled that pension contributions that were based on unallowable compensation were, themselves, unallowable. The Board wrote:

Northrop Grumman drafted its pension plan such that a portion of it (the portion the government seeks to disallow) is paid based upon executive salary that exceeds the statutory cap. To put it another way, if Northrop Grumman were not paying a salary above the statutory cap, it would not have paid the challenged portions of the pensions at issue. ...

At bottom, it is the amount of the pension cost - determined in part by compensation that exceeds the cap - that would not have been incurred but for incurrence of the participant's compensation exceeding the cap. In that manner, the challenged pension costs were generated by Northrop Grumman's inclusion in its pension formula of amounts that exceeded the cap. As the government notes, it was Northrop Grumman that created the Retirement Benefit Formula for determining pension benefits. Northrop Grumman was free to structure it in such a way that its formula did not include amounts above the applicable compensation cap. The fact that Northrop Grumman chose to include costs above the cap does not justify its now seeking reimbursement from the government for pension costs that were determined based upon the excess costs. Clearly, the additional pension cost for which appellant requests reimbursement would not have been incurred had appellant not paid its pensioners compensation that exceeded the cap.

At the end of the day, the Board cited to its previous 2020 *DynCorp* decision, which also disallowed certain severance costs when they were based on compensation that exceeded the FAR ceilings. We didn't care for that decision—and we explained why in

[our article](#)

. However, this decision seems far less tortuous to us.

Any other compensation that is based on unallowable compensation is, itself, unallowable. That's the rule—whether you like it or not.