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Pension Funds; Forward Pricing and Billing Rates

Government contractors with defined benefit plans need to assess quickly whether the recent decline in the stock market only exacerbates contractors' cash flow problems caused by the Government's delay in harmonizing funding requirements imposed by the Pension Protection Act ("PPA") with Cost Accounting Standards ("CAS") 412 and 413's limits on what may be treated as allowable costs. On September 2, 2008, the CAS Board issued its long-awaited Notice of Proposed Rulemaking ("NPRM") regarding harmonization of the PPA with CAS. However, comments on the NPRM are not due until November 3, 2008 and it is uncertain whether the final rule will be effective by the PPA required date of January 1, 2010 or what form it will take. Nevertheless, in the meantime, contractors should act promptly to protect themselves from the impact of the stock market's decline, by requesting appropriate modification to their ('FPR"), and Billing Rates.

FAR 42.1701(c), provides for cancellation of FPRs "at the option of either party. . . ." Consequently, contractors with FPRs, but whose defined benefit pension fund has experienced a substantial change in the value of its assets, as well as its prospects for realizing its projected earnings, have the option of proceeding under FAR 42.1701 (d), which provides:

> "When an FPRA is invalid, the contractor should submit and negotiate a new proposal to reflect the changed conditions. If an FPRA has not been established or has been invalidated, the ACO will issue a forward pricing rate recommendation ("FPRR") to buying activities with documentation to assist negotiators."
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> Likewise, FAR 42.704(c) provides that Billing Rates:
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> "[O]nce established, . . . may be prospectively or retroactively revised by mutual agreement with the contracting officer . . . or auditor and the contractor at either party's request, to prevent substantial overpayment or underpayment."

It is likely that the government will resist changing FPRs and Billing Rates arguing that the market is volatile in the short term but will rebound in the medium term. The severity of the decline makes this a dubious position. To help support the appropriateness of rate adjustments, contractors should use credible information from their actuaries and other third parties, as well as experience with prior significant market declines, such as what occurred in October 1987.

"Irrespective of whether contractors seek modification to their FPR and Billing Rates, contractors should ensure that all fiduciaries' duties under the plan are met. Recently, plan fiduciaries have been scrutinized for their actions or inactions by participants and regulatory agencies. When fulfilling fiduciary duties, fiduciaries must act prudently and solely in the interest of plan participants; fiduciaries have a duty to select, monitor, and evaluate plan investments. Diversification, another fiduciary duty, helps to minimize the risk of large investment losses to the plan. Even if a fiduciary is diversifying and monitoring plan investments, past procedures used by fiduciaries may no longer be prudent due to changes in the investment markets and regulatory environment. Contractors should ensure that all of the fiduciary obligations are met, not only to comply with federal law, but to prevent additional losses in plan investments that the government could argue in response to requests to adjust Billing Rates are attributable to the fiduciaries rather than the turbulent market. We can assist contractors in

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understanding and meeting fiduciary duties for pension plans."

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