No. 03-128

In the Supreme Court of the United States

UNITED TECHNOLOGIES CORPORATION, PRATT & WHITNEY, PETITIONER

v.

DONALD H. RUMSFELD, SECRETARY OF DEFENSE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

THEODORE B. OLSON
Solicitor General
Counsel of Record
PETER D. KEISLER
Assistant Attorney General
DAVID M. COHEN
PATRICIA M. MCCARTHY
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTIONS PRESENTED

1. Whether the court of appeals correctly described the standard to be applied on remand in assessing whether the government should be equitably estopped from asserting that petitioner failed properly to apportion its indirect costs in connection with the performance of government contracts.

2. Whether petitioner incurs a cost, within the meaning of the Cost Accounting Standards (CAS) regulations, 48 C.F.R. Pts. 9903-9905, for commercial engine parts it procures from certain foreign suppliers.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

In the Supreme Court of the United States

No. 03-128

UNITED TECHNOLOGIES CORPORATION, PRATT & WHITNEY, PETITIONER

v.

DONALD H. RUMSFELD, SECRETARY OF DEFENSE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-29a) is reported at 315 F.3d 1361. The opinion of the Armed Services Board of Contract Appeals (Pet. App. 32a-110a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 15, 2003. A petition for rehearing was denied on April 23, 2003 (Pet. App. 30a-31a). The petition for a writ of certiorari was filed on July 21, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This matter arises against the backdrop of Cost Accounting Standards (CAS) applicable to cost-based government contracts. See 48 C.F.R. Pts. 9903-9905. CAS are intended, among other things, to provide a fair and rational way for government contractors to allocate their indirect expenses among their commercial customers and the government. Under CAS, a government contractor must accumulate certain indirect expenses that are not specific to any particular contract, and must allocate those expenses proportionally among its government and commercial contracts according to allocation bases. The allocation bases are comprised of various direct costs incurred by the contractor in performing its government and commercial contracts. See 48 C.F.R. 9904.410-40(d), 9904.410-50, 9904.418-50. The result is that a contractor's indirect expenses are allocated among its customers in proportion to direct costs. See Pet. App. 2a. The proportional allocation of indirect expenses determines the amount of those expenses that may be billed to the government.

2. Since the early 1980s, petitioner has procured engine parts from several foreign parts suppliers for use in its manufacture and sale of aircraft engines and spare parts to its commercial customers. Although petitioner initially contemplated forming joint ventures with certain of those foreign suppliers, it instead executed "collaboration" agreements. While the collaboration agreements vary somewhat, they share certain salient aspects. First, each foreign supplier pays petitioner an "entry fee" for the right to use its technology. Second, petitioner pays each supplier a share of revenues "in consideration of" the parts, with the amount of payment based on a percentage of the price received on

petitioner's sale of engines or spare parts as reduced by a portion of petitioner's expenses (a deduction known as "drag"). Third, each agreement expressly states that petitioner and the suppliers are independent contractors rather than joint venturers or partners. See Pet. App. 3a-4a.

In practice, petitioner commingles the foreign-supplied parts with other purchased parts. To sell the engines and spare parts to its customers, petitioner takes title to the foreign-supplied parts immediately prior to petitioner's delivery to a customer. Petitioner alone sells the engine and spare parts to its customers, and the foreign parts suppliers have no direct relationship with petitioner's customers. See Pet. App. 3a, 5a.

Until 1996, petitioner treated its payments to the foreign parts suppliers as a "cost of sales" for financial accounting purposes. During that time, however, petitioner excluded those payments from its cost allocation bases when apportioning its indirect costs among its commercial and government contracts. That exclusion had the effect of decreasing the amount of overhead and indirect expenses allocated to petitioner's commercial contracts, thereby increasing the amount of those expenses allocated to its government contracts. See Pet. App. 7a-8a.

3. a. On January 24, 1992, the responsible Defense Logistics Agency contracting officer issued to petitioner a finding of noncompliance with CAS based on petitioner's failure to include in its cost allocation bases the cost of parts obtained from foreign suppliers under the collaboration agreements. Pet. App. 8a. On December 2, 1996, another contracting officer issued a final decision finding that petitioner's CAS violations for the period between 1984 and 1995 resulted in overcharges

to the government in excess of $157 million plus interest. *Id.* at 8a-9a.

b. Petitioner appealed to the Armed Services Board of Contract Appeals (the Board), contending that it incurred no cost under CAS in procuring the foreign-supplied parts. Pet. App. 9a. Petitioner also asserted as an affirmative defense that the government should be estopped from seeking recovery on its claim for the period from 1984 to 1991. *Id.* at 12a, 106a.

The Board sustained petitioner's appeal. Pet. App. 32a-110a. In the Board's view, the relationship between petitioner and the foreign suppliers is analogous in substance to joint ventures and consignments, and petitioner's payments to the suppliers are analogous to distributions (or a "pass through") of revenue under Generally Accepted Accounting Principles (GAAP). *Id.* at 100a-105a. The Board therefore concluded that petitioner did not violate CAS by failing to treat the payments for foreign parts as costs when calculating its cost allocation bases. *Id.* at 105a. The Board relied on a finding that petitioner "never takes title" to the foreign-supplied parts incorporated into its engines. *Id.* at 103a; see *id.* at 102a. The Board acknowledged that the collaboration agreements required petitioner to pay the foreign suppliers "in consideration of the parts manufactured," but the Board found that other provisions in the contracts suggested that petitioner did not incur a cost for the parts. *Id.* at 104a. Because the Board determined that petitioner's payments to foreign suppliers do not constitute costs under CAS, the Board expressly declined to rule on petitioner's "lengthy estoppel defense." *Id.* at 106a.

4. The court of appeals vacated and remanded, holding that petitioner's payments to the foreign suppliers constitute a cost that must be included in petitioner's

cost allocation bases. Pet. App. 1a-29a. The court explained that the term "cost" in CAS includes an outlay made by a business to purchase materials. *Id.* at 15a-16a. The court found that petitioner's acquiring of parts under the collaboration agreements constituted a purchase of materials. The court reasoned that, under the Uniform Commercial Code (UCC), those transactions qualified as "sales," *i.e.*, the passing of title in a good for a price. *Id.* at 17a. The court explained that petitioner was obligated by the collaboration agreements to pay a price to the suppliers for the parts, and that, contrary to the Board's finding, "there is no question but that [petitioner] * * * obtain[s] title to the parts." *Ibid.* The court also observed that excluding the cost of those parts would contravene the requirement of CAS that the cost allocation bases "represent the entire cost input," and thus would "cause a substantial distortion in overhead allocation." *Id.* at 19a.

The court rejected petitioner's argument that the substance of the transactions was controlling under GAAP and that the transactions in substance were joint ventures rather than sales of parts. Pet. App. 19a-25a. The court explained that GAAP applies only if CAS does not supply the relevant rule, and here, CAS required petitioner to include its payments to suppliers in its allocation bases. *Id.* at 20a-21a. The court further noted that, even if GAAP applied, petitioner had failed to demonstrate that GAAP requires disregarding the legal form of a transaction in favor of its alleged "economic substance." *Id.* at 21a-22a. Petitioner could not rely on GAAP in any event, the court explained, because petitioner, in purported accordance with GAAP, treated its payments to the foreign suppliers as a cost in its financial reports until the time of this dispute. *Id.* at 23a-24a; see *id.* at 7a. The court also rejected

petitioner's reliance on tax cases, explaining that taxpayers are barred from recharacterizing a transaction in order to avoid payment of taxes, and that petitioner thus "would be bound by the consequences of the commercial transaction as it chose to structure it, *i.e.*, as the purchase of parts from the foreign parts suppliers." *Id.* at 26a.

Finally, the court observed that petitioner's estoppel defense "remains open on remand." Pet. App. 28a. The court noted the "well settled" rule that petitioner, "[b]eyond a mere showing of acts giving rise to an estoppel, * * * must show '*affirmative misconduct* [as] a prerequisite for invoking equitable estoppel against the government.'" *Ibid.* (quoting *Heckler* v. *Community Health Servs.*, 467 U.S. 51, 60 (1984), and *Zacharin* v. *United States*, 213 F.3d 1366, 1371 (Fed. Cir. 2000)).

ARGUMENT

1. The petition does not warrant this Court's review for the threshold reason that the Court generally awaits final judgment in the lower courts before exercising its certiorari jurisdiction. See *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967) (per curiam); *American Constr. Co.* v. *Jacksonville, Tampa & Key West Ry.*, 148 U.S. 372, 384 (1893). The court of appeals vacated the Board's decision and remanded for further proceedings, including adjudication and resolution of petitioner's estoppel defense.

The interlocutory posture of the case "of itself alone furnishe[s] sufficient ground for the denial" of the petition. *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916); see *Virginia Military Inst.* v. *United States*, 508 U.S. 946 (1993) (Scalia, J., respect-

ing denial of certiorari); Robert L. Stern et al., *Supreme Court Practice* § 4.18, at 196 n.60 (7th ed. 1993). The denial of certiorari at this time does not preclude petitioner from raising the same issues in a later petition, after the entry of final judgment. The practice of deferring review until final judgment promotes judicial efficiency by ensuring that, in the event that judgment ultimately is entered against petitioner, all of petitioner's claims—or at least those that petitioner concludes are most meritorious—will be consolidated and presented in a single petition to this Court.

2. Petitioner argues (Pet. 13-21) that the court of appeals erred in describing the standard for the Board to apply on remand in assessing whether, for the period from 1984 to 1991, the government is equitably estopped from claiming that petitioner failed correctly to allocate its indirect expenses. That contention lacks merit and does not warrant review.

a. There is no merit to petitioner's threshold contention (Pet. 15) that the court of appeals lacked authority to "tell[] the Board in advance what the proper legal standard for judging estoppel should be." The cases relied on by petitioner (Pet. 14-15) are inapposite. To be sure, appellate courts generally decide cases on the grounds advanced by the parties and avoid deciding issues not resolved by a lower court, but there is no prohibition against addressing other issues in appropriate cases. See, *e.g.*, *Kolstad* v. *American Dental Ass'n*, 527 U.S. 526, 540 (1999) ("This Court has not always confined itself to the set of issues addressed by the parties."); *Arcadia* v. *Ohio Power Co.*, 498 U.S. 73, 77 (1990) (deciding case on grounds not raised by parties or considered by court of appeals); *Teague* v. *Lane*, 489 U.S. 288, 319-320 (1989) (Stevens, J., concurring in part and concurring in the judgment). In any event, the

court of appeals in this case did not resolve petitioner's estoppel defense. Instead, the court described the standard to be applied by the Board in adjudicating that defense. See *Kolstad*, 527 U.S. at 539-546 (describing standards to be applied on remand for imputing punitive damages liability to employer even though issue not raised by parties or reached by court of appeals). Petitioner may advance factual and legal arguments in support of its estoppel defense on remand. If the Board ultimately denies the defense and rules against petitioner, petitioner will be free at that time to seek appellate review.

b. In any event, the court of appeals did not err in describing the standard that should be applied to petitioner's estoppel defense. This Court has repeatedly held that "estoppel will not lie against the Government as it lies against private litigants." *OPM* v. *Richmond*, 496 U.S. 414, 419 (1990); see *Heckler* v. *Community Health Servs.*, 467 U.S. 51, 60 (1984). Accordingly, the Federal Circuit holds that "affirmative misconduct * * * is necessary to estop the Government," *Henry* v. *United States*, 870 F.2d 634, 637 (Fed. Cir. 1989); *Hanson* v. *OPM*, 833 F.2d 1568, 1569 (Fed. Cir. 1987), and other courts of appeals have adopted the same standard, see, *e.g.*, *Tefel* v. *Reno*, 180 F.3d 1286, 1303 (11th Cir. 1999) (citing cases), cert. denied, 530 U.S. 1228 (2000).

The decisions of this Court relied on by petitioner (Pet. 17) do not address the application of estoppel principles. Those decisions therefore do not support petitioner's contention (Pet. 16-21) that the heightened standards that normally apply when estoppel claims are made against the government are inapplicable when the government is acting in a proprietary capacity rather than in a regulatory or "sovereign" capacity. Indeed, in

Zacharin v. *United States*, 213 F.3d 1366 (Fed. Cir. 2000), on which the court of appeals relied in this case (see Pet. App. 28a), the court applied the "affirmative misconduct" standard in a patent case in which the government was acting in its proprietary capacity. See 213 F.3d at 1371. Although petitioner asserts (Pet. 18-20) that the court of appeals' opinion in this case conflicts with previous decisions of that court, none of those decisions addresses or discusses the affirmative misconduct standard. In any event, there is no occasion for this Court to review an asserted intra-circuit disagreement. See *Wisniewski* v. *United States*, 353 U.S. 901 (1957) (per curiam). Review is particularly unwarranted at this stage of the proceedings because neither the court of appeals nor the Board has had occasion to apply any estoppel standard to the facts of this case.

3. Petitioner asserts (Pet. 22-30) that the court of appeals erred in concluding that petitioner's payments to foreign suppliers under the collaboration agreements constituted costs under CAS for purposes of calculating petitioner's allocation bases. That contention, which turns on the specific facts of the relationship between petitioner and its foreign suppliers and on the particular terms of petitioner's collaboration agreements, does not warrant review. Petitioner's claim lacks merit in any event.

Petitioner argues (Pet. 24-26) that the court of appeals failed to interpret the CAS according to the customs and usages of the trade. But petitioner does not identify any specific terms that the court allegedly misconstrued. Because the term "cost" is not defined in the CAS, the court properly considered the context of the CAS, relevant dictionary definitions, the GAAP definition of "cost" accepted by the parties, the meaning

of related terms in the UCC, and the usage and definition of "cost" and "material cost" in the Federal Acquisition Regulation. See Pet. App. 14a-17a. All of those sources support the court's conclusion that "cost" includes an "outlay for materials 'purchased.'" *Id.* at 16a.[1]

There is no merit to petitioner's reliance (Pet. 27-30) on the supposed "economic substance" of its transactions under the collaboration agreements. Petitioner acknowledges that the foreign suppliers receive "something" for supplying engine parts. Pet. 23. Indeed, the collaboration agreements expressly require petitioner to pay the suppliers in consideration of parts manufactured if, and only if, the suppliers actually provide parts. See Pet. App. 17a n.12. Thus, the plain language of the contracts provides for a payment in return for the parts, and that exchange constitutes a cost even under the definition accepted by the Board. See *id.* at 39a (defining cost as "that which is given up or forgone to consume, to save, to exchange, to produce").

Petitioner maintains that the "economic substance" of its relationship with foreign suppliers under the collaboration agreements is more like that of "risk-bearing co-venturers" (Pet. 22) than independent contractors, notwithstanding that those agreements specifically state that petitioner and the suppliers are inde-

---

[1] While petitioner's amicus Washington Legal Foundation (WLF) argues that the court improperly rejected expert testimony concerning the meaning of the term "cost," see WLF Br. 6, the court's definition of "cost" ultimately was no different from that of petitioner or petitioner's experts. See Pet. App. 15a-16a. Moreover, while amicus generally objects to the court's treatment of petitioner's expert testimony on the meaning and application of CAS, the court of appeals correctly recognized that the interpretation of CAS presents an issue of law, not fact.

pendent contractors. Petitioner argues (Pet. 23-24), in particular, that the passing of title should not affect whether petitioner's payments to suppliers constitute costs under CAS. As petitioner acknowledges, however, there is no separate entity that incurs the cost of the foreign suppliers' engine parts, incorporates those parts into engines, and sells the engines to commercial customers. See Pet. App. 19a. The passing of title to the parts from the suppliers to petitioner therefore is not a mere "technicality." Pet. 28. Instead, the transfer of title is necessary to permit petitioner's sale of engines to its customers. See Pet. App. 17a. Because there is no separate entity—*i.e.*, an actual joint venturer—petitioner must purchase the parts directly from the suppliers. Otherwise, petitioner would lack the ability to convey to its customers the title to an engine containing collaboration parts. See *ibid.*[2]

Moreover, even if petitioner and its foreign suppliers could fairly be characterized as "risk-bearing co-venturers" (Pet. 22), that would be irrelevant. As the court of appeals explained, "adoption of such a vague rule, which depends on experts' judgments as to the 'substance' of a particular transaction, and the views of experts as to the appropriateness of using the 'substance' approach in any particular case, is inconsistent with the basic principles of government contracts accounting." Pet. App. 24a. The CAS aim to ensure uniformity and consistency in cost allocation practices. See *id.* at 24a-25a. That objective forecloses the "amor-

---

[2] For that reason, petitioner errs in relying (Pet. 28) on *Florida Power & Light Co.* v. *United States*, 307 F.3d 1364 (Fed. Cir. 2002). In that case, the passage of title to the government was merely incidental to the transaction. *Id.* at 1373. Here, by contrast, there can be no sale unless there is passage of title to petitioner.

phous" approach proposed by petitioner (*id.* at 25a), under which payments for parts could be found not to constitute costs even if the payments were characterized as costs at the time they were made and the parties structured their relationship accordingly.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

THEODORE B. OLSON
Solicitor General
PETER D. KEISLER
Assistant Attorney General
DAVID M. COHEN
PATRICIA M. MCCARTHY
Attorneys

OCTOBER 2003