UNITED STATES
CIVILIAN BOARD OF CONTRACT APPEALS

DENIED: November 5, 2018

CBCA 5642

ADAMS AND ASSOCIATES, INC.,

Appellant,

v.

DEPARTMENT OF LABOR,

Respondent.

Tiffinay Barker Pagni, General Counsel of Adams and Associates, Inc., Reno, NV, counsel for Appellant.

Dennis A. Adelson and Peter J. Dickson, Office of the Solicitor, Department of Labor, Washington, DC, counsel for Respondent.

Before Board Judges **HYATT**, **VERGILIO**, and **RUSSELL**.

VERGILIO, Board Judge.

Adams and Associates, Inc. (contractor) had a cost reimbursement contract with the respondent, the Department of Labor (agency). A contracting officer determined that reimbursable rental costs are limited to the costs of ownership because of the connection between the contractor and lessor of the building, previously owned by the contractor. The contractor seeks more than the agency has allowed, contending a sale and leaseback did not occur and that there was no common control to impose limitations. Further, the contractor seeks an adjustment for facilities capital cost of money within the amount in dispute. The agency recognizes that such facilities costs could be allowable, but contends that the amount is not allowable here because the contractor failed to specifically identify the amount in its cost proposal.

The Board concludes that a sale and leaseback occurred, and that the entities involved in the lease are under common control. Each of these factors separately limits the allowable reimbursement under applicable regulations. The contractor has not proven its facilities capital cost of money or that an adjustment is appropriate. The Board denies the appeal.

Findings of Fact

Under a cost plus incentive fee contract, the contractor operated a Jobs Corps Center. The base period was December 1, 2013, through May 31, 2014, with two three-month option periods. The contract dictated that the agency would reimburse the contractor in accordance with the Federal Acquisition Regulation (FAR) Allowable Cost and Payment (Dec 2002) clause, 48 CFR 52.216-7 (2012) (FAR 52.216-7) (although the parties stipulate to the 2013 version of the clause; here without a material difference). The clause specifies that payments will be made in accordance with FAR part 31.2 in effect on the date of the contract and the terms of the contract. Rental costs under operating leases are allowable, subject to various conditions, with express limitations for rental costs either under a sale and leaseback arrangement or when charges are made between organizations under common control. FAR 31.205-36.

The parties have stipulated to the following facts for this case:

1. Appellant, Adams and Associates, Inc. (AAI), is a Nevada Corporation, duly organized in the State of Nevada on September 25, 1990, with its principal place of business the Headquarters Building in Reno, Nevada.

2. AAI is a 100% employee-owned company with the sole purpose of operating Job Corps Centers through contract with the United States Department of Labor (DOL). AAI currently employs approximately 2500 employees at 19 locations across the United States.

3. AAI became a 100% employee-owned company through implementation of an Employee Stock Ownership Plan (ESOP) in 2012. Prior to becoming a 100% employee-owned company, AAI was owned by shareholders Roy Adams, Leslie Adams, and the Daniel B. Norem Revocable Trust.

4. The ESOP was adopted by AAI's Board of Directors on October 24, 2012, with an effective date of January 1, 2012. The Board of Directors and officers for AAI at this time

included: Roy Adams, CEO/President; Leslie Adams, Secretary; and Daniel B. Norem, Vice-President/Treasurer.

5. AAI owned the Headquarters Building prior to implementation of the ESOP in 2012, under which AAI employees acquired ownership of the company from former shareholders Roy Adams, Leslie Adams, and the Daniel B. Norem Revocable Trust. Depreciation and other building expenses were included in AAI's allowable general and administrative costs.

6. During the ESOP negotiations in 2012, certain conditions were imposed, requirements that had to be met in order for the ESOP to go forward. These included: (i) the ESOP had to be 100% employee owned; (ii) the former principals had to agree to stay involved as management consultants for 5 years with no ownership (instead they are subject to written management consulting agreements); and (iii) the ESOP had to increase its operating funds to satisfy the ESOP Trustee and the financial institution involved in the deal. In order to implement the ESOP and provide AAI employees an ownership interest in the company, the ESOP was structured in order to meet all three conditions.

7. In order to raise funds to support the acquisition of the stock of AAI from its former owners, on October 16, 2012, AAI entered into a Purchase Agreement with Sierra Sky Properties, LLC, a Nevada limited liability company (Sierra), by which AAI sold its Headquarters Building to Sierra. The members of Sierra were Roy Adams, Leslie Adams, and Daniel B. Norem. At that time, the Headquarters Building was approximately 16% depreciated, based on an IRS depreciation schedule for commercial buildings of 39 years duration.

8. Pursuant to the Purchase Agreement, the parties agreed that at the time of closing on the sale, they would execute a lease by which Sierra would lease the Headquarters Building to AAI. The independent ESOP trustee reviewed and approved the lease and its terms as part of the ESOP transaction.

9. On October 24, 2012, Sierra and AAI entered into a lease pursuant to which AAI leased the Headquarters Building from Sierra (Lease), for use by AAI as its corporate headquarters. The Lease had a term of 10 years, commencing on the date that Sierra closed escrow and acquired fee simple title to the premises, which was to be on or before October 25, 2012. The Lease also had four 5-year options. Pursuant to the Lease, AAI was obligated to pay rent, utilities, and property taxes, and to maintain the premises in good repair. The rental payments specified under the Lease were established based on an independent appraisal of market rates performed by the Johnson Group. Those rates exceeded AAI's prior costs of

ownership of the Headquarters Building. In separate and later transactions, AAI sublet space of the Headquarters Building to additional third parties, independent of AAI and Sierra.

10. Also on October 24, 2012, AAI became an ESOP corporation. On that date, the employees of AAI became the 100% owners of the corporation and ESOP Trustee Alan Weisman was appointed. The new officers of AAI were: Roy Adams, President/CEO; Leslie Adams, Secretary; Daniel B. Norem, Vice-President/Treasurer; and Susan Larson, President of Job Corps Operations. The Members of its Board of Directors were: Roy Adams, Leslie Adams, Daniel B. Norem, and John S. Adams (no relation to Roy & Leslie Adams).

11. On November 26, 2013, the Department of Labor awarded Contract No. DOLJ141A22163 (Contract) to AAI. That Contract contained the clause at FAR 52.216-7, Allowable Cost and Payment (June 2013). Pursuant to that clause, DOL is obligated to reimburse AAI for its allowable and allocable costs, as incurred in the performance of the Contract. These include direct costs and indirect costs.

12. On June 28, 2013, AAI submitted an Indirect Cost Rate Proposal to DOL, for review and approval by DOL's Cost Determination Division of its indirect cost rate for the calendar year 2012. AAI fully disclosed the formation of the ESOP and the sale and lease of the Headquarters Building as well as the impact of the transaction on the 2012 indirect rate.

13. DOL audited that proposal and accepted AAI's rate of 7.41%. DOL subsequently audited AAI's Indirect Cost Rate Proposal for calendar year 2013 (submitted November 12, 2014), and challenged the rental costs on the basis of alleged common control between AAI and Sierra. A compromise was reached in order to resolve the issue quickly. Finally, DOL audited AAI's indirect costs for calendar year 2014 (as set forth in an Indirect Cost Rate Proposal of August 13, 2015), and challenged the rental costs on the basis that they were the result of a sale and leaseback. DOL's cost evaluators determined on October 31, 2016, that the costs to be included in AAI's indirect cost pool, as related to its rental expenses for the Headquarters Building, should be limited, in accordance with FAR 31.205-36(b), to the prior costs of ownership of the Headquarters Building. That decision was appealed by AAI to the contracting officer on November 22, 2016. The contracting officer issued a decision of January 9, 2017, disallowing AAI's claimed reimbursement.

14. AAI disputes the decision of the contracting officer with respect to the application of FAR 31.205-36(b) and the limitations set forth therein.

15. The difference between the calculation of AAI's indirect cost rate, as applied to 2014 direct costs, under DOL's interpretation of FAR 31.205-36(b), and under AAI's interpretation, is valued at $160,410, with a deduction of $40,974 for depreciation, resulting

in a net value of $119,436. That is the principal amount claimed by AAI in this appeal. AAI is also disputing DOL's failure to include Facilities Capital Cost of Money as an allowable cost in DOL's computation of cost of ownership.

Discussion

While an initial motion by the contractor seeking summary relief was pending, the parties submitted the case on the written record pursuant to Board Rule 19. 48 CFR 6101.19 (2017). The agency did not allow the full amount paid for rent by the contractor. It determined that a sale and leaseback occurred, and limited payment to the normal costs of ownership. This resulted in denying rental charges of $160,410, but allowing a depreciation offset of $40,974. The contractor seeks to recover the total disallowance of $119,436, on the basis that its actual rental costs are fully allowable. The agency also posits common control as a basis to limit recovery. If the agency's limitation prevails on the basis of common control, the contractor contends that it is entitled to an offset of $26,551 for facilities capital cost of money. While the agency contends that this amount should be disallowed because the contractor did not specifically identify this cost in its cost proposals, the contractor maintains that this offset was not relevant under its view that rental costs are fully allowable and it has raised this in response to the agency's recent assertion of common control as a basis for limitating payment.

Rental costs are an allowable, reimbursable expense; however, rental costs under a sale and leaseback arrangement are allowable only up to the amount the contractor would be allowed if the contractor retained title computed based on the net book value of the asset on the date the contractor becomes a lessee of the property with some adjustments. Further, charges in the nature of rent for property between organizations under common control are allowable to the extent that they do not exceed the normal costs of ownership, with adjustments allowed. FAR 31.205-36(b).

The Board reviews this matter de novo. The contractor contends that a sale and leaseback did not occur. Asserting that a precondition for a sale and leaseback is that a lessee must have previously owned the sold property and leased it back, it raises what it contends is a material distinction between the contractor as a privately held company, and as a 100% employee-owned ESOP company. It states that the former company sold the property and the successor company leased the property, so that the distinction between the two companies precludes a sale and leaseback. The agency counters that there was no material change in the company–one company was the contracting party, as there was no novation with the change in ownership. The parties also take opposing views on the applicability of the regulatory provision limiting reimbursement when a lease exists between companies under common control.

The contractor owned the building at the start of 2012 (and earlier), but as of January 1, 2012, the later-signed ESOP agreement became effective. On October 16, 2012, the contractor sold the building to Sierra, with the proviso that a lease agreement would become binding. On October 24, 2012, Sierra leased the building to the contractor. The situation reflects a sale and leaseback. The Board utilizes the approach and adopts the rationale detailed in *Talley Defense Systems, Inc.*, ASBCA 39878, 93-1 BCA ¶ 25,521, at 127,156-58 (1992), when that board was faced with similar questions concerning common control and the sale leaseback issue. This contractor owned the building, sold the building, and leased it back. The sale and leaseback limits the contractor's recovery. The contractor has identified no improper calculation in the determination of the allowability of reimbursable costs.

Even without considering the retroactive effective date of the ESOP agreement, as the agency notes, the contractor owned the building throughout until it sold the building to Sierra and thereafter leased it. This is a sale and leaseback that triggers the limitations on allowability in the regulations. The contractor's suggestions that the limitations harm the employee owners is not relevant nor borne out by the record.

Also serving to limit and define the allowable lease expense under the regulation is the common control among the various companies, given the involvement of the individuals serving as officers of the contractor as the ESOP became effective, serving on the board of directors and as officers of the contractor prior to the effective date and signing of the ESOP agreement, and as members of Sierra. As dictated in the regulation, normal costs of ownership define the allowable costs, not the rent paid when a lessor and lessee are under common control. *Thomas Associates, Inc.*, ASBCA 57795, 12-2 BCA ¶ 35,162, at 172,550; *Talley*, 93-1 BCA at 127,155-56.

The contractor contends that facilities capital cost of money is an allowable cost, not considered by the agency. The agency contends that the contractor is barred from such an allowance because, contrary to regulation, FAR 31.205-10(b)(3) (cost of money is allowable, provided that the estimated facilities capital cost of money is specifically identified and proposed in cost proposals relating to the contract), the contractor failed to specifically identify an amount in its cost proposals for this contract. The facilities capital cost of money was not relevant under the contractor's theory of entitlement to its rental costs, before the agency determined that payment of actual rental costs was not appropriate. However, because the evidentiary record does not support any dollar figure for the related facilities capital cost of money, the Board cannot make an adjustment under the cost principles and regulations.

Decision

The Board **DENIES** the appeal.

Joseph A. Vergilio
JOSEPH A. VERGILIO
Board Judge

We concur:

Catherine B. Hyatt
CATHERINE B. HYATT
Board Judge

Beverly M. Russell
BEVERLY M. RUSSELL
Board Judge