U.S. Department of Labor

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Issue Date: 04 June 2003

CASE NOS.: 2000-OAA-0002, 2001-OAA-0001, 2001-OAA-0002

In the Matter of:

NATIONAL COUNCIL OF SENIOR CITIZENS,
Complainant in Case Nos. 2000-OAA-0002, 2001-OAA-0001, 2001-OAA-0002, and

NATIONAL SENIOR CITIZENS EDUCATION AND RESEARCH CENTER,
Complainant in Case Nos. 2001-OAA-0001, 2001-OAA-0002,

v.

UNITED STATES DEPARTMENT OF LABOR,
Respondent.

Before: PAMELA LAKES WOOD
Administrative Law Judge

ORDER GRANTING PARTIAL SUMMARY DECISION

The matter before this tribunal concerns the cross motions for summary decision filed by the parties in the instant consolidated cases. For the reasons set forth below, the motions are granted in part.

STATEMENT OF THE CASE

These three cases have been brought under the provisions of the Senior Community Service Employment Program (SCSEP), authorized by the Older Americans Act, as amended, 42 U.S.C. §§ 3056, 3056a to 3056n, with implementing regulations appearing at 20 C.F.R. Part 641, and 29 C.F.R. Part 96, subpart F. They involve challenges by grantees to the disallowance of costs under three separate audits. The three cases, which have been consolidated solely for administrative purposes, are:

(1) Case No. 2000-CAA-002, brought by the National Council of Senior Citizens[1] against the U.S. Department of Labor, docketed on March 20, 2000 and assigned to the undersigned for disposition, based upon an appeal of the disallowance of $4,961,583 in total costs during the audit period from July 1, 1992 through June 30, 1995 [relating to Grant Nos. D-3797-2-00-81-55, D-4231-3-00-81-55, and D-4549-4-00-81-55], by a Final Determination of March 2, 2000;

(2) Case No. 2001-OAA-0001, brought by both the National Council of Senior Citizens and the National Senior Citizens Education and Research Center against the U.S. Department of Labor, docketed on November 28, 2000, and assigned to Judge Stuart Levin for disposition, based upon an appeal of the disallowance of $1,030,332 in total costs during the audit period from July 1, 1995 through June 30, 1996 [relating to Grant No. D-5102-5-00-81-55, as modified on May 15, 1996 by adoption of a Novation Agreement], by a Final Determination of November 21, 2000; and

(3) Case No. 2001-OAA-0002, brought by both the National Council of Senior Citizens and the National Senior Citizens Education and Research Center against the U.S. Department of Labor, docketed on June 6, 2001, and assigned to Judge Stuart Levin for disposition, based upon an appeal of the disallowance of $2,152,387 determined to be subject to debt collection for the audit period from July 1, 1996 through December 31, 1997 [relating to Grant Nos. D-5822-5-00-81-55 and D-6135-7-00-81-55], including an adjusted $622,988 for indirect costs during the three audit periods, by a final determination of May 31, 2001.[2]

The Respondent U.S. Department of Labor ["the Grant Officer"] filed a motion for consolidation in the above captioned matters, which motion was opposed by Complainant National Council of Senior Citizens and Complainant National Senior Citizens Education and Research Center. A meeting was held between counsel for the parties, the undersigned administrative law judge (the presiding judge in Case No. 2000-OAA-0002), and Judge Stuart Levin (the presiding judge in Case Nos. 2001-OAA-0001 and 2001-OAA-0002). Discussion at the conference revealed that all three cases arise from grants which involve similar issues but different time periods and audits. The National Council of Senior Citizens ("the Council") was the original grantee but its responsibilities were later

[1] The National Council of Senior Citizens will be referenced herein as "the Council" or "NCSC" and the National Senior Citizens Education and Research Center will be referenced as "the Research Center" or "NSCERC." The Council and the Research Center will be referenced collectively as "Complainants." The Respondent U.S. Department of Labor will be referenced herein as "the Grant Officer" or "DOL."

[2] Although $2,442,802 was questioned for the year, the total amount subject to debt collection was $2,152,387. (AF-2 12). As explained below, that amount reflects adjustments of indirect costs for the three audit periods.

assumed by the National Senior Citizens Education and Research Center ("the Research Center.") Judge Levin and the undersigned agreed limited consolidation would be in the interest of administrative convenience and judicial economy. ***See generally*** 29 C.F.R. § 18.11. The main objection to consolidation was that the Council and the Research Center wished to retain whatever defenses they might have in separate actions and were concerned that they might be prejudiced by consolidation. Accordingly, in my Order of Consolidation of November 21, 2001, I determined that this matter would be consolidated for administrative purposes without affecting the substantive rights of the parties. Thereafter, all three cases were assigned to the undersigned for disposition.

Following consolidation of the cases, on December 11, 2001, the parties jointly proposed a schedule for proceeding in the cases. The schedule was proposed because the parties believed that the bulk of the issues presented in this case could be resolved by summary decision. I adopted the proposed schedule, as well as subsequent changes proposed by the parties during the course of the extensive briefing.

The following motions, memoranda, and exhibits[3] have been submitted with respect to the cross motions for summary judgment:

(1) Complainant's Motion for Summary Decision on Finding No. 1 [4] (relating to all cases) and a Statement of Undisputed Facts related thereto, filed on May 15, 2002;

(2) Complainant's Motion for Summary Decision on Stand-in Costs [5] (relating to all cases) and a Statement of Undisputed Facts related thereto, filed on May 15, 2002;

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[3] The Administrative Files, including the Audit Reports and the Grant Officer's Final Determination, were also submitted for each of the three cases. ***See*** 20 C.F.R. § 636.10(g). The administrative files for Case Nos. 2000-OAA-0002 (three volumes), 2001-OAA-0001 (one volume), and 2001-OAA-0002 (one volume) will be referenced as "AF-1", "AF-2" and AF-3", respectively, followed by the page number.

[4] Finding No. 1 relates to the determination by the Grant Officer that certain payments, which Complainants have deemed to be royalties, were actually premium refunds or rebates which should have been recredited to the Grant. As discussed below, Complainants have asserted that the disputed amounts paid by Monumental Life Insurance Company were royalties paid for use of the NCSC name and logo.

[5] Stand-in costs are excess grant program costs paid from non-federal sources which are substituted for costs disallowed by the auditor, thereby enabling the grantee to receive the full amount of the grant. Here, as discussed below, the stand-in costs claimed by Complainants consist of administrative costs reported as excess "cash match" program costs, which Complainants allege were cash outlays in excess of the requirement that 10% of program costs be assumed by the grantee. The Grant Officer has asserted that the amounts claimed as "stand-in costs" were "donations" and cannot be used for this purpose.

(3) Three binders of Exhibits submitted by Complainants in support of the two above motions, including (a) Deposition Transcripts and Exhibits Thereto, including the transcripts and exhibits from the depositions of Jaime G. Salgado, Mollie Harris, Linda D. Kontnier, Ross Shearer, Jr., Lance Grubb, Edwin Terrell, and Melvin Weiser; (b) the Declarations, with exhibits, of Margaret Bartel, Robert J. Mozer, Donald E. Loren, Joseph R. Gallagher, Scott E. Hallberg, Charles H. Ross, James C. Kokolas, and Geoffrey D. Brown); and (c) the Grant Officer's Response to Complainant's Third Request for Production of Documents and Interrogatories, with privilege log, attachments and selected exhibits, all of which were filed with this tribunal on May 15, 2002;

(4) the Grant Officer's Response to Complainant's Motion for Summary Decision on Finding No. 1 and Motion for Summary Decision on Stand-in Costs, filed on July 18, 2002;

(5) Complainants' Reply in Support of Complainant's Motions for Summary Decision on Finding No. 1 and on Stand-In Costs (All Cases), filed on September 9, 2002;

(6) Grant Officer's Motion for Partial Summary Decision, filed on May 22, 2002;[6]

(7) the Grant Officer's Appendix (annexed to the Grant Officer's Motion for Partial Summary Decision), incorporating the Grant Officer's Exhibits (in addition to the administrative files), including OMB Circulars A-122 and A-110; decisions of the Internal Revenue Service, the Comptroller General, and the H.H.S. Departmental Appeals Board; various grant documents and Form SA1s and SA1-As; and JTPA [Job Training and Partnership Act] Financial Management Guide excerpts, all of which were filed on May 22, 2002;

(8) the Grant Officer's Appendix, Volume 2 (annexed to the Grant Officer's Response to Complainants' Motion for Summary Decision on Finding No. 1 and Motion for Summary Decision on Stand-in Costs), including a December 13, 1994 letter from Mozer & Swetnick to the NCSC with attached opinion; excerpts from depositions previously submitted by Complainants; OMB Circular A-133; and the declarations with exhibits of Edwin McClellan Terrell Jr., Lance Grubb, and Jaime Salgado, all of which were filed on July 18, 2002;

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[6] In addition to arguing that DOL should prevail on the "Finding No. 1" and "Stand-In Costs" issues, the Grant Officer argues that the costs addressed in "Finding No. 2" (relating to health insurance administration fees) are unallowable because these costs were already charged directly to the federal grants. In addition, the Grant Officer argues that the Council and the Research Center are jointly and severally liable for debts incurred during the first two grant periods (July 1, 1992 to June 30, 1995 and July 1, 1995 through June 30, 1996) and the Research Center is liable as the prime grantee for debts incurred during the third grant period (July 1, 1996 through December 31, 1997).

(9) Complainants' Response to the Grant Officer's Motion for Partial Summary Decision and Cross-Motion for Summary Decision, filed on July 17, 2002; and

(10) the Grant Officer's Reply to Complainant's Response to the Grant Officer's Motion for Partial Summary Decision, filed on September 12, 2002.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

FACTS

NCSC and NSCERC. The National Council of Senior Citizens (NCSC) was incorporated on March 20, 1962 as a not-for-profit organization, and later that same year (October 30, 1962), the National Senior Citizens Education and Research Center (NSCERC), another non-profit organization, was also incorporated. (Mozer Dec. ¶¶ 3, 6; Brown Dec. Ex. 1; Kokolas Dec. Ex. 1).[7] While the two organizations were tied together through a common management, the Research Center's purposes were exclusively charitable, educational, and scientific, while the Council served as a voice for senior citizens and had broader responsibilities, which included attempting to influence legislation.[8] (Brown Dec. Ex. 1 p. 7). The Council became a grantee under the Senior Community Service Employment Program ("SCSEP"), a program which involves sponsoring the employment of low-income older Americans as "Senior Aides" primarily in local public agencies. (Mozer Dec. ¶¶ 4, 5). The NCSC Senior AIDES Grant Program 1992-1993 Grant Application describes the program in some detail. (AF-1 450-539). The Council continued to apply for and receive SCSEP grants for fiscal years 1993, 1994,

[7] References to declarations submitted in support of the cross motions will be cited by the name of the declarant and the paragraph number of the declaration and/or the exhibit number or letter (***e.g.*** Mozer Dec. ¶ 2, Mozer Dec. Ex. 1). References to depositions will be to the deponent's name followed by the page number of the transcript (***e.g.*** Mozer Dep. p. 3; Mozer Dep. Ex. 2). Where quoted language appears in bold, the bold font has been added for emphasis and does not appear in the original unless otherwise indicated.

[8] In its financial statement for FY 1994, the Council described its mission as "to promote the interests of senior citizens in the United States in harmony with the national interests, encourage greater opportunities for voluntary civic service for senior citizens, act as a clearing house for the exchange of information, ideas and experiences among affiliated members and groups, engage in fact finding and analysis of issues, publish the results of such studies, provide a responsible and articulate voice for senior citizens, leadership training opportunities for senior citizens, by conducting workshops, institutes and other types of educational programs, promote social welfare by attempting to influence legislation and take such other action as is consistent with the interest and needs of senior citizens." (Brown Dec. Ex. 1 p. 7).

1995, and the first half of fiscal year 1996.[9] (Gallagher Dec. ¶ 4; AF-1 189-539; AF-2 168-285). Due to legislative changes [specifically, the Lobbying Disclosure Act of 1995, which prohibits tax-exempt organizations engaging in lobbying from receiving federal funds], responsibility for the grants was transferred to the Research Center beginning on January 1, 1996. (Mozer Dec. ¶ 6; Brown Dec. Ex. 7; AF-1 920, 943). To implement this change, the Council (as Transferor) and the Research Center (as Transferee) entered into a Novation Agreement with the United States Government effective December 31, 1995, but signed by the Grant Officer on May 16, 1996. (AF-2 282-284, 284(a)-285). The Research Center received SCSEP grants for calendar years 1996 and 1997. (Gallagher Dec. ¶ 5; AF-3 200-437). The Council and the Research Center organizationally separated on October 1, 1999. (AF-3 147).

Reporting under SCSEP Grants. The SCSEP grants are cost-sharing grants, with the federal obligation limited to 90% of total project costs, which means that the grantee is required to match the federal contribution by paying 10% of the total project costs from non-federal sources. (Gallagher Dec. ¶ 6). Both the Council and the Research Center were assisted by approximately 150 subcontractors or subrecipients in performing the purposes of the SCSEP grant, and each subcontractor submitted periodic funding requests for reimbursement of the federal share of its costs, which requests were submitted on Form SA1s, "Sponsor's Request for Funding." (Gallagher Dec. ¶¶ 7 to 9 and Ex. 1). The subcontractors periodically reported their program costs on the grantee's Form SA1-A, "Sponsor's Detailed Statement of Costs," which indicates the actual incurred program costs paid with non-federal funds, broken down as Cash Component (cash payments for direct program costs), Indirect Component (cash payments for indirect program costs), and In-Kind Component (fair market value of donated property or volunteer services.) (Gallagher Dec. ¶¶ 10 to 12 and Ex. 2). The subcontractors were also required to have their federal and non-federal costs audited under the Single Audit Act and the results of the audits were transmitted to the grantee (first NCSC and then NSCERC). (Gallagher Dec. ¶ 15). Each fiscal year, the grantee was required to report the breakdown between the federal and non-federal shares of the program costs on Financial Status Reports ("FSRs.") (Gallagher Dec. ¶ 14). The final versions of FSRs for fiscal years 1993

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[9] For grant purposes, the first half of fiscal year 1996 is actually the period from July 1, 1995 to December 31, 1995, even though Chief Accountant Gallagher stated that it is from July 1, 1996 to December 31, 1996 in his Declaration. (Gallagher Dec. ¶ 4). (The attachments to Mr. Gallagher's Declaration, together with the rest of his Declaration, including paragraph 5, show that the statement in paragraph 4 was in error, as NSCERC took over the grant effective December 31, 1995. See also AF-2 168, 284(a)). In 1996, NCSC changed its accounting period to a calendar year, so there is a short 6-month period ending on December 31, 1996 that has been designated Fiscal Year 1996X or FY96X. (Brown Dec. ¶¶ 17 to 19, 21-22 and Ex. 1 to 4, 12; AF-3 96). See footnotes 10, 21 and 29 below.

through 1998[10] reported the following total program outlays, federal share, non-federal share, and excess cash payments for program costs (the latter of which was reported under item 12, Remarks, as documented on the recipient's books of accounts):[11]

Fiscal Year	Total Outlays/ Federal Share	Non-Fed. Share/ 3d Party In-kind/ Only Cash Contrib.	Cash Payments over required match reported on books
1993	$70,292,115/ $60,999,151	$9,292.964/ $ 995,338/ $8,297,626	$2,515,281
1994	$69,891,839/ $60,754,027	$9,137,812/ $2,363,189/ $6,774,623	$2,387,364
1995	$70,851,543/ $61,593,655	$9,257,888/ $2,357,995/ $6,899,893	$2,414,149
1996	$68,873,253/ $59,867,193	$9,006,060/ $2,598,770/ $6,407,290	$2,354,150

[10] A July 1 to June 30 fiscal year is used for the grants concerned here, and initially NCSC used a corresponding fiscal year. However, NCSC changed its accounting period in 1996 to a calendar year, so there is a short 6-month period ending on December 31, 1996 that has been designated Fiscal Year 1996X and the subsequent "fiscal years" referenced in the third audit are calendar years, even though the grant year was unchanged (***e.g.***, July 1, 1997 to June 30, 1998). (AF-3 96, 200). The grantee was NCSC for FY 1993, FY 1994, FY 1995, and the first half of FY1996 while NSCERC was the grantee for all of calendar years 1996 and 1997. (See footnote 9 above). Although the Financial Status report for FY 1998 related to the period from July 1, 1997 to June 30, 1998 (corresponding with the grant year), the federal audit only covered the first portion of the period, ending on December 31, 1997. (Gallagher Dec. ¶ 33 and Ex. 8; AF-3).

[11] The FSRs are dated in November 2000 and according to Melvin Weiser, who was formerly associated with Myint and Buntua, they were not in the same form at the time of the audit. (Weiser Dep. p. 68-71). In fact, the original forms for the grant years up to June 30, 1996 did not reference the cash payments in excess of the match appearing on the books and allocated all of the non-federal payments to "in-kind." Compare Gallagher Dec. Ex. 3, 4, 5, 6 (also appearing as Salgado Dep. Ex. 2, 3, 4, 5) with Salgado Dec. Ex. 7, 8, 9, 10.

Fiscal Year	Total Outlays/ Federal Share	Non-Fed. Share/ 3d Party In-kind/ Only Cash Contrib.	Cash Payments over required match reported on books
1997	$70,228,882/ $61,176,027	$9,052,855/ $2,679,443/ $6,373,412	$2,255,519
1998	$74,766,210/ $65,422,145	$9,344,065/ $2,704,538/ $6,639,527	$2,074,938

(Gallagher Dec. ¶¶ 18 to 35 and Ex. 3 to 8). The stand-in costs claimed by Complainants based on excess non-federal cash match payments (shown on the books) for the three grant periods were $7,316,794, $2,354,150, and $3,292,988, respectively, for a total of $12,963,932 for the three audit periods. (Gallagher Dec. ¶¶ 18-39). According to NCSC/NSCERC Chief Accountant Gallagher, these "excess match costs" were "primarily local administrative costs paid by the subrecipients." (Gallagher Dec. ¶ 39).

HIP and Med. Supp. Coverage. Throughout its existence, the Council has offered various benefits, including health insurance, to its 300,000 to 400,000 members. (Mozer Dec. ¶¶ 7, 8). Insurance offered to members included hospital indemnity program coverage (known as "HIP") and insurance coverage to supplement Medicare benefits (known as "Med. Supp."), and members who elected coverage were fully responsible for any premiums. (Mozer Dec. ¶¶ 9 to 12; Bartel Dec. Ex. 4). During the period from 1974 until 1988, coverage was provided through Century Insurance Company. (Mozer Dec. ¶ 12). Beginning in 1988, Monumental Life Insurance Company ("Monumental") (now part of AEGON Insurance Group) took over responsibility for providing coverage under the program, in accordance with a "Retention Agreement" and an "Administrative Service and Marketing Agreement."[12] (Mozer Dec. ¶¶ 15, 16; Loren Dec. ¶¶ 2, 3; AF-1 782-85,

[12] Paragraph 2 of the August 1988 Retention Agreement between NCSC and Monumental provides: "Each year, a Retention Accounting will be prepared and presented by Monumental, along with any resulting **Premium Refund**, if one is payable, within 90 days of the end of each Retention Accounting Year." (AF-1 783). Elsewhere in the agreement there are provisions relating to the calculation of the premium refund. The contemporaneous Administrative Service and Marketing Agreement, considered along with Exhibit A thereto, provides that Monumental will perform certain duties relating to the solicitation and enrollment of members under the HIP and Med. Supp. programs and further provides that Monumental will pay NCSC 4% of certificate holders' first year and renewal year earned premiums "as consideration for NCSC's marketing support services [performed by NCSC's membership development, membership record, and

(continued...)

787-93). During the same year, the Council began offering coverage to Senior Aides as elective fringe benefits, with premiums to be paid by grant funds under DOL approval. (Mozer Dec. ¶¶ 14, 21-22).

Insurance Agreement of 1992. On November 30, 1992 (effective October 1, 1992), NCSC and Monumental entered into an Insurance Agreement, which related to both the HIP and Med. Supp. programs. (AF-1 795-804). That Agreement stated the understanding of the parties that administrative responsibility for both programs, including premium collection and remittance and other specified duties (specified in sections II and III), would be transferred to Seabury and Smith, Inc., an insurance broker and third party administrator, but that NCSC would monitor Seabury's performance and would be responsible for other specified marketing duties (specified in section I).[13] (AF-1 795-97; Mozer Dec. ¶ 17). The Insurance Agreement provided for the following payments to be made:

> (1) Under section III(2) of the agreement, Monumental agreed to "remit to NCSC an amount equal to 14.5% of earned premium as compensation within thirty (30) days after receipt of gross earned premium by Monumen[t]al from Seabury" (which would be reflected as administrative fees under section V(1)(g))[14] and "[i]n consideration for performance of Seabury's administrative duties and functions, NCSC then

[12](...continued)
publication departments], which shall include but not be limited to Monumental's **use of NCSC's mailing list and logo for marketing purposes** and Monumental's right to promote insurance programs, through any and all NCSC publications and membership meetings, and for NCSC efforts to study and develop appropriate programs for senior citizens, and to reimburse NCSC for costs incurred therein." (AF-1 788, 793)

[13] Under section I, the Council was generally responsible for soliciting eligible members and distributing brochures and other promotional materials. Under section I(1)(b), which defines "Advertising Production Expenses" and "Advertising Dissemination Expenses," marketing/advertising expenses were to be "allocated and apportioned" as set forth in section V. (AF-1 795-96). Section V(1)(f) further defines Advertising Production and Dissemination Expenses and provides that they may only be incurred with the prior written approval of Monumental and NCSC. They are factored into the calculation of Retention as defined in section V(1)(g) but are not otherwise referenced in section V. See footnote 14 ***infra***.

[14] Section V(1)(g) relates to "Retention," which "is defined as the sum due Insurer [Monumental] which is made up of the following for the Policies for each Retention Accounting Year: 12% of the first $6,000,000.00 of Earned Premium each Policy Period, plus 11.5% of all Earned Premium in excess of $6,000,000.00 each Policy Period, plus Advertising Production and Dissemination Expenses, plus 2.5% state premium taxes paid or payable, plus 14.5% **administrative fees** paid to NCSC." (AF-1 799).

shall pay to Seabury an amount of compensation to be agreed upon between NCSC and Seabury from those funds remitted to NCSC by Monumental";

(2) Under section V(2), it is provided in part that "[e]ach year, a Retention Accounting will be prepared and presented by Insurer [Monumental], along with any resulting **Premium Refund**, if one is payable, within 60 days of the end of each Retention Accounting Year";[15] section V(3) provides for yearly calculation (as part of the Retention Accounting) of an Aggregate Balance in a manner similar to that of the 1988 Retention Agreement;[16] section V(4) provides that, to the extent that the Retention Accounting results in the calculation of a positive Aggregate Balance result, "that balance will be returned to NCSC as a **Refund**"; section V(5) provides that if the Retention Accounting results in a negative Aggregate Balance, it will carry over as "Deficit Accumulated"; section V(6) provides that references to dollar amounts for specific items refers to the aggregate sum under all policies set forth in Exhibit A (***i.e.***, the HIP and Med. Supp. policies); and section V(7) indicates that there is no guarantee of a **Refund** to NCSC.[17]

(AF-1 795-804). The 1992 Insurance Agreement does not mention royalties or the use of logos or mailing lists nor does it mention any specific administrative duties assumed by Monumental itself. (***Id.***)

Due to a ruling by the Department of Health and Human Services, which prohibited employers from offering insurance coverage secondary to Medicare to active employees, Med. Supp. coverage to Senior Aides was discontinued in December 1992, although it continued to be offered to Council members. (Mozer Dec. ¶ 23). The Med. Supp. program for Council members was discontinued in the latter part of calendar year

[15] The Retention Accounting Year ends on July 31. (AF-1 798).

[16] The Underwriting Result for the Retention Accounting Year ("Year") is calculated based upon "Earned Premium [defined as the premium earned during the Year for the coverages provided by Monumental] Less Retention [see footnote 14] Less Claims [Claims paid during the Year plus Claims Reserve and liabilities at the end of the prior Year] and Claims Reserve [a reasonable reserve established by Monumental]." The Aggregate Balance is the Underwriting Result for the Year less any Deficit Accumulated at the beginning of the Year plus any Contingency Reserve at the beginning of the Year plus any Contingency Reserve Interest Credit for the Year less any Contingency Reserve at the end of the Year. (AF-1 800).

[17] Section V(1) provides definitions, including the method for valuation of expenses and calculation of the Claim Reserve, Retention, Contingency Reserve, and Contingency Reserve Interest Credit. (AF-1 799-800).

1995. (Terrell Dep. Ex. 2). The HIP coverage for title V enrollees was cancelled by NCSC/NSCERC on August 26, 1999 effective September 30, 1999. (AF-1 581-583).

Letter Agreement between NCSC and Monumental. By a letter agreement of June 25, 1993, NCSC and Seabury (with Monumental listed as a party but not having signed on the copy submitted) agreed that Seabury would deduct 14.5% from the gross premiums and thereafter would remit the net premiums to Monumental and 4% of the gross premiums to NCSC, retaining 10.5% for compensation. (AF-1 806).

Royalty Agreement of 1994. In an undated agreement made effective on January 1, 1994, NCSC, Monumental, and Life Investors Insurance Company of America executed a "Royalty Agreement" (as a modification of the 1992 Insurance Agreement) which provided, ***inter alia***:

> Any and all payments made to the National Council of Senior Citizens under sections V (3), (4), (5), (6) and (7) are royalty fees paid to the National Council of Senior Citizens solely for the use of its name and logo in solicitation of insurance.

(AF-1 808). The 1994 Royalty Agreement also provided that the 1992 Insurance Agreement would not be construed as constituting a partnership or agent/principal relationship between the parties, and NCSC agreed to indemnify both insurance companies for any liability resulting from the inclusion of the provision in the Insurance Agreement. (AF-1 808).

Rebates paid by Monumental. According to Robert J. Mozer, the Council's General Counsel from 1979 or 1980 until 2000, there were no payments from Monumental under Section V of the 1992 agreement in the fiscal year ending on June 30, 1993 [FY 1993], but such payments amounted to $100,000 for the fiscal year ending June 30, 1994 [FY 1994]. (Mozer Dec. ¶ 27). The payments under Section V were $1,800,000 for the period ending June 30, 1995 [FY 1995], $850,000 for the period ending June 30, 1996 [FY 1996], and $800,584 for the six-month period ending on December 31, 1996 [FY 1996X]. (Brown Dec. ¶ 12, 17-19, 21). The amount of $450,000 was reported as "royalty revenue" on the tax return (Form 990) for calendar year 1997, in addition to $77,383 in "membership promotions" (administrative fees for the HIP and Med. Supp. programs), $31,114 for "insurance refund" (refund of insurance premiums paid), and $32,647 for "misc. reimbursements."[18] (Ross Dec. Ex. 1). The Section V amounts so reported total $4,000,584.00.

[18] There was a separate calendar year 1997 tax return for unrelated business income, Form 990T (Ross Dec. Ex. 1).

In practice, the Section V payments were made to NCSC by Monumental in the form of an "account payable on demand" (the "retention account" or "Special Holding Fund"), while the administrative fees of 14.5% under Section III were withheld from the premiums by Seabury and 4% was directly paid to NCSC. (Terrell Dep. Ex. 2; Salgado Dep. Ex. 15). The record before me is not entirely clear on the issue of when the actual Section V drawdowns were made from the retention account. As reported by the Deputy Inspector General, as supplemented by the Experience Exhibits from Monumental, the actual draw downs were made on the following dates, in the following amounts:

November 1, 1993	$100,000
July 26 or 28, 1994	100,000
August 31, 1994	200,000
November 2, 1994	200,000
December 7, 1994	200,000
April 10, 1995	100,000
June 30, 1995	767,758 (also reported as $1,000,000)[19]
October 24, 1995	250,000
May 7, 1996	600,000
September 5, 1996	300,584
October 1, 1996	500,000
June 17, 1997	200,000
December 23 or 31, 1997	250,000
January 19, 1998	250,000 (after audit periods)
March 31, 1998	1,100,000
October 1, 1998	900,000
Total	$6,018,342 (or $6,250,584)
Total During Audit Period	3,768,342 (or $4,000,584)

[19] According to a file memorandum by Bond Beebe (CPA Gail Vallieres) of December 6, 1995, the June 1995 experience rating payments amounted to $1,000,000. (AF-1 863-864). Available records do not otherwise indicate when the additional draw down in FY 1995 occurred. Deputy Inspector General Patricia Dalton suggested in a memorandum prepared during the audit that a drawdown in the amount of $132,242 occurred at an unknown time, because the total reported "operating revenues" [reported as royalties] on the financial statements for FY 1995 was $1,800,000. Salgado Dep. Ex. 22 p. 5; compare Salgado Dep. Ex. 15 (summary of drawdowns), Salgado Dep. Ex. 19B (financial statement for FY 1995; also appearing as Ex. 2 to Brown Dec.) However, Ms. Dalton's analysis is incorrect as she has included a payment from November 1993, the prior fiscal year, of $100,000; the actual amount unaccounted for is $232,242. It is also worth noting that the statement of undisputed facts on Finding No. 1 prepared by Complainants incorrectly lists the FY 1995 payments as $1,850,000 (instead of $1,800,000, the amount reported as royalties on the tax returns and financial statements.)

(Salgado Dep. Ex. 15 p. 1 (at 000036); see also Salgado Dep. Ex. 22; Weiser Dep. Ex. 3; Terrell Dec. ¶ 9, Ex. 1 to 6; AF-1 863-875; AF-2 88.)

Based upon information provided by Monumental as Experience Exhibits for each of the Retention Accounting Years, Supervisory Auditor Edwin McClellan Terrell, Jr. reported the breakdown of HIP and Med. Supp. Gains and Losses for each of the retention periods.

Retention Period	HIP Gains or (Losses)	Med Supp Gains or (Losses)	Total Annual Gains or (Losses)	Cumulative Gains or (Losses)
8/92-7/93	$ 986,210	$ (663,343)	$ 322,867	$ 322,867
8/93 - 7/94	1,419,222	(511,050)	908,172	1,231,019
8/94 - 7/95	1,453,478	(429,105)	1,024,373	2,255,412
8/95 - 7/96	948,983	254,984	1,203,967	3,459,379
8/96 - 7/97	964,101	0	964,101	4,423,480
8/97 - 7/98	733,943	0	733,943	5,157,423
Total	$6,505,937	$(1,348,514)	$5,157,423	

(Terrell Dec.¶ 9, Ex. 1 to 4 [appearing at App. Vol.. 2, Tab 18]).

Reporting of Rebates on Tax Returns and Financial Statements. According to General Counsel Mozer, income received from Monumental under Section V of the 1992 Agreement was consistently reported as royalty income on the Council's tax returns and financial statements. (Mozer Dec. ¶ 26). However, although Mr. Mozer indicated that there were "royalty payments" of $100,000 in the fiscal year ending June 30, 1994 (Mozer Dec. ¶ 27) and there was a corresponding withdrawal of $100,000 from the Special Holding Fund on November 1, 1993 (Salgado Dep. Ex. 15 p. 3 (at 000044)), the tax return for the period from July 1, 1993 until June 30, 1994 [which bears the date 1993] does not mention royalty payments, and the unconsolidated financial statements for same period are similarly lacking.[20] (Brown Dec. Ex. 1, 9). According to Geoffrey D. Brown,

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[20] The amount reported as "other revenue" from income-producing activities on line 103 of Part VII (as explained in Part VIII) of the 1993 tax return (actually relating to FY 1994) includes $22,654 for "conventions & conf" ("convention for senior citizen members - providing meetings and forum on senior citi[zens] issues"), $97,259 for "natl. healthcare prog" ("program focusing on the national healthcare debate and its impact on the senior citiz[ens] community"), and (continued...)

principal with Bond Beebe, which prepared the tax returns for the Council from 1993 through 1996,[21] the payments were properly reported as "other revenue" with an explanation that they were from "royalties" on the tax return for the fiscal year ending June 30, 1995, for the fiscal year ending June 30, 1996, and for the fiscal year ending on December 31, 1996.[22] (Brown Dec. ¶¶ 12, 13, 18, 19, 27 and Ex. 9, 10, 11, and 12). However, Mr. Brown went on to say that upon a "review and investigation" by Bond Beebe conducted during an unspecified time period, which included a review of the agreements between the Council and Monumental and an interview with Monumental Vice President Don Loren, "Bond Beebe concluded that NCSC received three different types of payments from Monumental, royalty payments and two types of administrative fees" and that "Bond Beebe concluded that NCSC received the royalty payments **based upon NCSC's good experience rating**." (Brown Dec. ¶¶ 14 to 16). For calendar years 1997, 1998 and 1999, both Scott E. Hallberg and Charles H. Ross, tax partners and certified public accountants with the accounting firm of Thomas Havey LLP (which prepared the returns), opined that the payments were properly reported as tax-exempt royalty income on NCSC's tax returns. (Hallberg Dec.¶¶ 1, 2, 4, 7; Ross Dec. ¶¶ 1, 2, 4, 7 and Ex. 1).

Single Audit Act Audits by Bond Beebe and Thomas Havey LLP. The audits conducted under the Single Audit Act from 1994 to 1997 did not comment upon any irregularities in the reporting of royalties. The accounting firm of Bond Beebe audited the financial statements of the Council for fiscal years 1994, 1995, and 1996 under the Single Audit Act and found them to present fairly the financial position of NCSC in all material respects. (Brown Dec. ¶¶ 3 to 8, Ex. 1 to 8). Thomas Havey LLP, the same firm that prepared tax returns for the Council (as discussed above), also audited the Research Center for calendar year 1997 under the Single Audit Act and determined that the payments under Section V were properly excluded by the Research Center from its

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[20](...continued)
$13,460 for "miscellaneous" ("miscellaneous services to members"). (Brown Dec. Ex. 9). Nonexcludable "Advertising" income of $209,281 is listed as "program service revenue" which is "unrelated business income" on line 93a of Part VII. (***Id.***) There is no mention of royalties on the return or the accompanying statements and schedules. (***Id.***).

[21] The 1993 tax return for NCSC covers the period from July 1, 1993 to June 30, 1994, the 1994 tax return covers the period from July 1, 1994 to June 30, 1995, the 1995 tax return covers the period from July 1, 1995 to June 30, 1996, and the 1996 tax return covers the period from July 1, 1996 to December 31, 1996 and bears the heading "<u>CHANGE OF ACCOUNTING PERIOD</u>." (Brown Dec. Ex. 9, 10, 11, 12).

[22] Although indicating that the payments under section V were properly reported as "revenue" on financial statements and as "income" on tax returns for the fiscal year ending June 30, 1994, Mr. Brown did not discuss the amount of such payments for that fiscal year or how they were specifically reported. (Brown Dec. ¶¶ 10, 11 and Ex. 6).

financial statements for 1997 because the payments were made to the Council. (Kokolas Dec. ¶ 3 to 10 and Ex. 1). Thomas Havey LLP also determined that the 1997 financial statements presented fairly, in all material respects, the financial position of the Research Center for that year. (Kokolas Dec. ¶ 8 and Ex. 1).

IRS Audit. Following an audit, IRS determined that income derived by the Council from the insurance program with Monumental Life Insurance was royalty income during calendar years 1997, 1998 and 1999, because the program was operated without services being rendered, and an audit of the period ending June 30, 1996 also did not result in a change of tax liability. (Hallberg Dec. Ex. A and B). It appears, however, that IRS may not have been provided with complete information in a response by Thomas Havey LLP to its inquiry relating to tax years 1997 and 1998. (Bartel Dec. ¶¶ 3, 4, 9 and Ex.1, 2).[23] Although the IRS also audited the Council for the period from July 1, 1996 to December 31, 1996, the declarations do not address the outcome of that audit. (Hallberg Dec. ¶¶10, 13,15).

Opinions by NCSC General Counsel and Monumental VP. Persons who were involved in the transactions continue to maintain that the payments from the Insurance Company were properly reported as royalty income. Mr. Mozer, who was the Council's General Counsel during all relevant periods, opined that the payments under Section V of the 1992 Agreement were for the use of the Council's name and logo in solicitation of insurance to Council members and Senior Aides, and that the Royalty Agreement was entered into for the purpose of "describing NCSC's royalty income with particularity for tax purposes." (Mozer Dec. ¶¶ 20, 25). The former Vice President of Monumental (now AEGON), Donald E. Loren, has agreed that the payments made under Section V were for the purpose of compensating the Council for use of its name and logo in the solicitation of business from members and Senior Aides (whom Monumental considered to be NCSC

[23] In an October 23, 2000 Information Document Request, IRS asked for an explanation as to the difference between royalty income for 1997 of $450,000 and for 1998 of $2,250,000. In a November 9, 2000 response, Margaret Bartel, a certified public accountant and former accounting consultant for Thomas Havey LLP, explained: "Royalty income is recorded on a cash basis in the year in which it was received by NCSC. The amounts recorded as income represent the actual cash received during the fiscal year. Royalties earned are based on a report developed by Monumental at the end of each insurance year (July 31). NCSC requests funds based upon the amount in its account. However, these requests must be approved by Monumental taking into consideration whether or not sufficient funds remain in the account to deal with any contingencies. The difference between 1997 and 1998 is based on the timing of the approval of Monumental for requested withdrawals." (Bartel Dec. ¶¶ 3 to 6, 9 and Ex. 1 and 2). No mention was made of the way in which premiums collected and claims paid during the pertinent year factored into the calculation, although the yearly variance was due in part to each of those factors. (Compare Section V(3) of the 1992 Agreement (AF-1 800) with the November 9, 2000 response (Bartel Dec. Ex. 1, 2). See also footnotes 14 and 16 above and accompanying text.)

members), and Mr. Loren asserts that the December 1994 Royalty Agreement was executed for the purpose of clarifying the intent of the parties. (Loren Dec. ¶¶ 5 to 8).

First Audit Report and Final Determination. The first Inspector General audit report, relating to costs claimed for Fiscal Years 1993, 1994, and 1995, was done by Myint & Buntua, CPAs under contract with the Office of Inspector General. By acceptance, the Final Report (Audit Report No. 18-99-007-07-735, issued on February 3, 1999 and signed by John J. Getek, Assistant Inspector General for Audit) became a report of the Office of Inspector General. (AF-1 81 to 188). In that report, \$5.8 million of costs (including \$5.5 million direct and \$336,000 indirect costs) were questioned and \$1.1 million in costs were identified as avoidable without affecting program operations. (AF-1 86). The following findings are directly relevant to these summary disposition motions:

B. QUESTIONED DIRECT COSTS

1. HIP PLAN REFUNDS

NCSC provides its Senior Aides (enrollees) Hospital Indemnity Plan (HIP) insurance. NCSC pays the entire premium and charges the cost directly to the DOL grant. The underwriter of the insurance plan - the Monumental Life Insurance Co. - advised NCSC that, based on the terms of the HIP agreement and its "favorable claims experience," NCSC earned substantial premium "refunds" for FYs 1993, 1994, and 1995. However, contrary to the allowable cost terms of the DOL grant, NCSC did not "credit" any of the refunds to DOL. The total amounts of the refunds for the three fiscal years was \$3,858,910.[24] **(Finding No. 1.)**

2. HIP PLAN ADMINISTRATIVE FEES

To compensate NCSC for its costs of performing the administrative functions for the HIP, the Monumental Life Insurance Co. pays NCSC an administrative fee of 14.5 percent of earned premiums, which NCSC "shares" with Seabury & Smith, Inc. – the "intermediary" who also performs certain administrative functions. NCSC credited the amounts that it received to "membership promotion income" instead of applying these amounts, as an "offset credit," to DOL grant costs which were directly charged for the administrative functions. We, therefore, credited DOL

[24] The Direct Costs Questioned for Finding No. 1 were \$986,210 for FY 1993, \$1,419,222 for FY 1994, and \$1,453,478 for FY 1995. (AF-1 87).

> grant costs for the amounts that NCSC received. The amounts received for the three fiscal years totaled $309,825.[25] **(Finding No. 2.)**
>
> However, based on the administrative functions performed by Seabury & Smith and NCSC, we believe that the 72/28 percent (Seabury vs. NCSC) fee allocation is an inadequate reimbursement to NCSC for the work that it performs compared to Seabury. We estimate that a 1/3 for Seabury and 2/3 for NCSC sharing arrangement would more equitably reflect the costs of the level of administrative functions performed by the two parties. Accordingly, we question the amounts paid to Seabury in excess of 1/3 of the total administrative costs. For the three fiscal years, these amounts totaled $438, 920. **(Finding No. 2.)**[26]

(AF-1 87). [Emphasis in Original].

An Initial Determination relating to the first audit was issued on April 13, 1999 (AF-1 59-80), a Revised Initial Determination was issued on July 27, 1999 (AF-1 41-56), and a Final Determination was issued on March 2, 2000 (AF-1 13-37). As corrected, the total disallowed by the Grant Officer was $4,961,583.[27] (AF-1 16; Final Determination for Case No. 200-OAA-2 ["FD-1"] p. 1). With respect to Finding No. 1 of the Direct Program Costs, the Grant Officer rejected the Council's assertion that the payments concerned were royalties and concluded that they were based upon excess premiums and therefore should have been returned to the DOL grant; thus, the Grant Officer continued to disallow the full amount of $3,858,910. (FD-1 p. 6]. However, on Finding No. 2, the Grant Officer accepted the negotiated fees paid to Seabury and Smith (in the amount of $813,289) but continued to disallow "[t]he amount received for administrative fees from HIP as membership promotion income, instead of as an offset or credit to the DOL SCSEP grant" ($309,825). (FD-1 p. 8). The Grant Officer also rejected the proposal by the Council and the Research Center that they be allowed to offset the costs proposed for disallowance through surplus non-Federal matching costs incurred by its subrecipients (amounting to approximately $9 million for the period from FY 1993 to FY 1996, of which $3.5 million related to FY 1996 alone) as "stand-in costs" because the value of donated services is not reimbursable under OMB Circular A-122, Attachment B, 10a(1)

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[25] The amount deemed to be an offset credit under the first paragraph of Finding No. 2 amounted to $84,907 for FY 1993, $114,480 for FY 1994, and $110,438 for FY 1995. (AF-1 87).

[26] The amount questioned as excess administrative costs under the second paragraph of Finding No. 2 amounted to $120,285 for FY 1993, $161,181 for FY 1994, and $156,454 for FY 1995. (AF-1 87). As noted below, these costs were accepted in the Final Determination (FD-1).

[27] The Grant Officer who issued all three final determinations was Jaime G. Salgado. (Salgado Dec. ¶ 2).

[now section 12], the subgrantees were required "to contribute their administrative costs to the program as part of their unreimbursable non-federal match," and allowance of the stand-in costs "would amount to paying the grantee for services it received for free." (FD-1 p. 12; AF-1 27).

Second Audit Report and Final Determination. The second IG audit report related to costs claimed for Fiscal Year 1996 and was also done by Myint & Buntua, CPAs under contract with the Office of Inspector General. The Final Report (Audit Report No. 18-99-011-03-360), was issued on September 24, 1999 and signed by Assistant Inspector General Getek. (AF-2 60 to 167). In that report, direct costs of $1,643,516 and indirect costs of $1,134,744 were questioned, for a total of $2,778,260. (AF-2 66). Of this amount, $948,983 related to Hospital Indemnity Plan Refunds under Finding No. 1, $101,207 related to HIP administrative fees treated as membership promotion income under the first paragraph of Finding No. 2, and $143,377 related to allegedly excessive administrative fees under the second paragraph of Finding No. 2 (AF-2 66-67). The Initial Determination was issued on March 24, 2000. (AF-2 42-59). Under the Final Determination of November 21, 2000 ("FD-2") the costs disallowed were reduced to $1,030,332. (AF-2 12-28). Based upon the same rationale as in the first audit, the Grant Officer allowed the administrative fees of $143,377 but continued to disallow the HIP refunds in the amount of $948,983 and HIP administrative fees received as membership promotion income of $101,207. (AF-2 15-20; FD-2 pp. 2-7). A file memorandum of February 1, 2001 indicated that the proposed stand-in costs (amounting to $9,006,060)[28] had been rejected. (AF-2 8-9).

Third Audit Report and Final Determination. The third IG audit related to the period from July 1, 1996 until December 31, 1997 and resulted in Audit Report No. 18-00-006-03-360 dated March 29, 2000, also prepared by Myint & Buntua and signed by Assistant Inspector General Getek. (AF-3 92-199). A total of $3.7 million in costs (including $1.9 million in direct costs and $1.8 million of indirect costs) were questioned, in addition to $2.2 million in lease buyout and moving expenses. (AF-3 97). With respect to Finding No. 1, the failure by the Research Center to credit $1,331,072 ($482,050 for "FY 96X"[29] and $849,022 for FY 97) in HIP Refunds was questioned, and with respect to Finding No. 2, administrative costs (treated as membership promotion income) of $121,368 ($42,909 for "FY 96X" and $78,459 for FY 97) were questioned. (AF-3 19, 98). An Initial Determination was issued on January 31, 2001. (AF-3 50-91). Under the Final Determination of May 31, 2001 ("FD-2"), a total amount of $2,152,387 was

[28] The stand-in costs claimed included the period from FY 1993 to FY 1996. (FD-1 p. 12; AF-1 27).

[29] Fiscal Year 1996X or FY 96X is defined as the 6-month fiscal period from July 1, 1996 to December 31, 1996, necessitated because NSCERC [the Research Center] changed its accounting period or fiscal year from July 1 through June 30 to a calendar year. (AF-2 96).

determined to be subject to debt collection, reflecting the lease buyout claim, $622,988 in indirect costs questioned for the entire period from June 30, 1991 through December 31, 1997, and other adjustments.[30] (FD-3 p. 2, AF-3 11-41). The Grant Officer continued to disallow the full amounts questioned under Findings Nos. 1 and 2 and also disallowed stand-in costs claimed in the amount of $3,342,303 based on the rationale that they were non-reimbursable donations under OMB Circular A-122, as with respect to the previous audits. (AF-3 16-21).

Adjusted Disallowances. In the Grant Officer's Motion for Partial Summary Decision, the Grant Officer indicates that as a result of the adjustments of indirect cost disallowances in the Final Determination for the third IG audit period and the allowance of costs previously disallowed, the revised totals of costs disallowed for the three audit periods are:

July 1, 1992 to June 30, 1995	$4,676.134
July 1, 1995 to June 30, 1996	1,030,282
July 1, 1996 to December 31, 1997	1,951,168

(Grant Officer's Motion for Partial Summary Decision at 11).

Stand-in Costs Consideration. In a Declaration of July 3, 2002, Richard Lance Grubb, Director of the Office of Grants and Contracts Management at the Employment and Training Administration, indicated that he was the Department reviewer who reviewed the partial stand-in proposal submitted by Complainants based upon an allegedly representative sample, and that his recommendation to Jaime Salgado, the Grant Officer, that the costs be rejected was based solely upon his determination that the claimed costs were nonreimbursable donations within the meaning of OMB Circular A-122. (Grubb Dec. ¶¶ 1, 4 to 7 [appearing at App. Vol. 2, tab 20]). Mr. Salgado accepted Mr. Grubb's recommendation. (Salgado Dec. ¶ 4 [appearing at App. Vol. 2, tab 21]). As a result, the review process was halted and the Department did not consider the relevant criteria set forth in Comptroller General Opinion B-208871.2, 68 Comp. Gen. 247, 1989 WL 237442 (Comp. Gen. Feb. 9, 1989); guidance manuals (such as the JTPA Guidelines); or analogous provisions in the JTPA regulations (appearing at 20 C.F.R. §§ 626.5 and 627.480(f)); nor was a determination made as to whether allowance of the stand-in costs

[30] In the transmittal letter of May 31, 2001 for the third final determination [FD-3], Jaime G. Salgado, Chief of the Division of Resolution and Appeals, explained that the impacts of indirect costs in the Final Determinations of March 2, 2000 [FD-1] and November 21, 2000 [FD-2] should be disregarded as the figure of $622,988 reflected "the total impact of indirect costs questioned for the periods of FYE 6/30/91 (sic) thru FYE 12/31/97." (AF-3 12). [Earlier grants were also audited and the lease concerned dated back to April 1991. (***E.g.***, AF-1 590-91, 650-59).]

would be a violation of the applicable cost limitations in 20 C.F.R. § 641.405(b)(1) (limiting administrative costs of SCSEP to 13.5%, subject to increase to 15%) or whether they were from the same program year they were proposed to replace. (Grubb Dec. ¶ 8; Salgado Dec. ¶ 5). Based upon a cursory review, Mr. Salgado opined that the proposed stand-in costs would not be allowable because they were incurred by the subrecipient Sponsors rather than Complainants. (Salgado Dec. ¶ 7).

LEGAL BACKGROUND

<u>Statutory Basis</u>

The Senior Community Service Employment Program (SCSEP) was authorized by the Older Americans Act, as amended, appearing at 42 U.S.C. §§ 3056, 3056a to 3056n. The statute sets forth certain match and cost requirements which are also set forth in the regulations, discussed below. 42 U.S.C. § 3056(c). Grantees are also required to comply with applicable uniform cost principles and administrative requirements for grants as set forth in OMB Circulars. 42 U.S.C. § 3056a(f)(2).

<u>OMB Circulars</u>

Three Office of Management and Budget Circulars are of particular relevance here: OMB Circular A-122, relating to allowable costs for non-profit organizations; OMB Circular A-110, relating to requirements for grants to non-profit organizations; and OMB Circular A-133, relating to audits of non-profit organizations. [31]

OMB Circular A-122. General principles relating to costs are addressed in Attachment A to OMB Circular A-122, "Cost Principles for Non-Profit Organizations." [32] Under section 3, only reasonable costs, which are "generally recognized as ordinary and necessary" are allowable, and under section 4, costs are allocable to a grant "in accordance with the relative benefits received." Section 5.a provides:

> 5. **Applicable credits.**
>
> a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are

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[31] Complete copies of OMB Circular A-122 (June 1, 1998), OMB Circular A-110 (September 30, 1999), and OMB Circular A-133 (June 24, 1997) appear at the Grant Officer's Appendix (Vols. 1 and 2), at Tabs 1, 2, and 17, respectively. The Circulars are also available at the OMB Home Page at <u>www.whitehouse.gov/OMB.</u>

[32] The cost principles in OMB Circular A-122 are applicable to SCSEP grantees that are non-profit organizations (with exceptions not relevant here) under 20 C.F.R. § 641.403(b)(1)(ii).

allocable to awards as direct or indirect costs. Typical examples of such transactions are: purchase discounts, **rebates** or allowances, recoveries or indemnities on losses, **insurance refunds**, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost, they shall be credited to the Federal Government either as a cost reduction or cash refund, as appropriate.

Attachment B to OMB Circular A-122 addresses selected items of cost. Section 12.a (1) [formerly section 10.a.(1)] of Attachment B provides:

12. **Donations.**

a. Services received.

(1) Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost.

Under paragraph (5) of the same subsection:

(5) The value of the donated services may be used to meet cost sharing or matching requirements under conditions described in Sec. __.23 of Circular A-110. Where donated services are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

Section 12.b. of Attachment B of the same Circular provides:

b. Goods and space.

(1) Donated goods; i.e., expendable personal property/supplies, and donated use of space may be furnished to an organization. The value of the goods and space is not reimbursable either as a direct or indirect cost.

(2) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in Sec.__.23 of Circular A-110. The value of the donations shall be determined in accordance with Sec.__.23 of Circular A-110. Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

OMB Circular A-110. The above-referenced provision in OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," provides criteria for cost sharing or matching as well as for the valuation of donated property or services. Specifically, subsection (a) of section __.23 (Cost sharing or matching) provides:

> (a) All contributions, including cash and third party in-kind, shall be accepted as part of the recipient's cost sharing or matching when such contributions meet all of the following criteria:
>
> (1) Are verifiable from the recipient's record.
>
> (2) Are not included as contributions for any other federally-assisted project or program.
>
> (3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.
>
> (4) Are allowable under the applicable cost principles.
>
> (5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.
>
> (6) Are provided for in the approved budget when required by the Federal awarding agency.
>
> (7) Conform to other provisions of this Circular, as applicable.[33]

Under subsection (d) of the same section, "[v]olunteer services furnished by professional and technical personnel, consultants, and other skilled and unskilled labor may be counted as cost sharing or matching if the service is an integral and necessary part of an approved project or program" and under subsection (e), "[w]hen an employer other than the recipient furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (plus an amount of fringe benefits that are reasonable, allowable, and allocable, but exclusive of overheard costs), provided these services are in the same skill for which the employee is normally paid." Paragraph (5) of subsection (h) requires documentation of volunteer services in "the recipient's supporting records for in-kind contributions from third parties."

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[33] Substantially the same requirements appear in 29 C.F.R. § 95.23(a), relating to DOL grants to non-profit organizations. The remainder of section 95.23 is substantially similar to its counterpart in the Circular.

Definitions are provided in section __.2 of Circular A-110 and its counterpart in Department of Labor regulations (29 C.F.R. § 95.2).[34] Cash contributions are defined as "the recipient's cash outlay, including the outlay of money contributed to the recipient by third parties." 29 C.F.R. § 95.2(f). "Outlays or expenditures" are defined as "charges made to the project or program," including "the sum of cash disbursements for direct charges for goods and services," the amount of indirect expense charged or incurred, the value of third party in-kind contributions, and either the amount of cash advances and payments made to subrecipients (for reports on a cash basis) or "the net increase (or decrease) in the amounts owed by the recipient for goods and other property received, for services performed by employees, contractors, subrecipients and other payees and other amounts becoming owed under programs for which no current services or performance are required" (for reports on an accrual basis). 29 C.F.R. § 95.2(y). "Third party in-kind contributions" is defined as the value of non-cash contributions provided by non-Federal third parties (in the form of real property, equipment, supplies and other expendable property, and the value of goods and services benefitting the project). 29 C.F.R. § 95.2(oo). "Project costs" is defined as all allowable costs incurred by a recipient and "the value of the contributions made by third parties in accomplishing the objectives of the award during the project period." 29 C.F.R. § 95.2(cc). "Subrecipient" is defined as "the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided" (including foreign and international organizations). 29 C.F.R. § 95.2(kk). "Program income" is defined as "gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award" (except as excluded under 29 C.F.R. § 95.24) and includes "income from fees for services performed, the use or rental of real or personal property acquired under federally-funded projects, the sale of commodities or items fabricated under an award, license fees and royalties on patents and copyrights [excluded below], and interest on loans made with award funds" but not interest on advances of federal funds and, unless specifically otherwise provided, "program income does not include the receipt of principal on loans, rebates, credits, discounts, etc., or interest earned on any of them." 29 C.F.R. § 95.2(bb)

Section __.24 (relating to Program income) of OMB Circular A-110 generally provides (in subsection (b)) for program income to be added to project funds, or used to fund the non-Federal share of the program, or deducted from allowable costs, with one exception. Subsection (h) of that section provides: [35]

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[34] The definitions in the Circular differ slightly and the subparts are referenced somewhat differently as additional definitions appear in the regulation. Citations herein are to the regulation.

[35] The provisions in subsections (h) and (e) of section __.24 appear in a substantially similar form in 29 C.F.R. § 95.24 (e) and (b), respectively. The counterpart to subsection (b) is § 95.24(a), which provides that except for royalty income, "program income earned during the project period shall be retained by the recipient and added to funds committed to the project by

(continued...)

> (h) Unless Federal awarding agency regulations or the terms and condition of the award provide otherwise, recipients shall have no obligation to the Federal Government with respect to program income earned from license fees and royalties for copyrighted material, patents, patent applications, trademarks, and inventions produced under an award. However, Patent and Trademark Amendments (35 U.S.C. 18) apply to inventions made under an experimental, developmental, or research award.

Under subsection (e) of the same section, unless otherwise provided in the awarding agency regulations or under the terms of an award, "recipients shall have no obligation to the Federal Government regarding program income earned after the end of the project period." ***See also*** 29 C.F.R. § 95.24(b) (same).

OMB Circular A-133. Audits of States, Local Governments, and Non-Profit Organizations are conducted under OMB Circular A-133. Section __.200(a) requires that non-Federal entities that expend $300,000 or more in a year in Federal awards have a single or program-specific audit conducted for that year. Under section __.215(a) of that Circular:

> **(a) Audit under this part in lieu of other audits.** An audit made in accordance with this part shall be in lieu of any financial audit required under individual Federal awards. To the extent this audit meets a Federal agency's needs, it shall rely upon and use this audit. The provisions of this part neither limit the authority of Federal agencies, including their Inspector Generals, or GAO to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any auditee to constrain Federal agencies from carrying out additional audits. Any additional audits shall be planned and performed in such a way as to build upon work performed by other auditors.

Regulations

Regulations relating to the grants under the Senior Community Service Employment Program (SCSEP) authorized by the Older Americans Act, as amended, 42 U.S.C. § 3056, appear at 20 C.F.R. Part 641. Under 20 C.F.R. § 641.402(a) (administrative requirements), the Department's regulations at 29 C.F.R. Parts 31, 32, 34, 93, 96 and 98 are also generally applicable. Regulations relating to audit requirements for

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[35](...continued)
DOL and recipient, and used to further eligible project or program objectives."

grants and contracts under OMB Circular A-133 appear at 29 C.F.R. Parts 96 and 99.[36] Grants to non-profit organizations under OMB Circular A-110 are also addressed in 29 C.F.R. Part 95 (which is applicable to non-profit SCSEP grantees under 20 C.F.R. § 641.402(a)) and the language in the regulations parallels that in the Circular, as discussed above.

Allowable costs are addressed in section 641.403, which references, ***inter alia***, OMB Circular A-122 and incorporates its requirements. Health insurance is an allowable fringe benefit cost under subsection (e). 20 C.F.R. § 641.403(e).

Costs are classified under three cost categories: (1) administration (including direct and indirect costs), (2) enrollee wages and fringe benefits, and (3) other enrollee costs. 20 C.F.R. § 641.404. "The amount of federal funds expended for the cost of administration during the program year shall be no more than 13.5 percent of the grant" subject to an increase "to no more than 15 % of the project in accordance with section 502(c)(3) of the OAA." 20 C.F.R. § 641.405(b)(1). "The amount of federal funds budgeted for enrollee wages and fringe benefits shall be no less than 75 percent of the grant." 20 C.F.R. § 641.405(b)(2).

Under section 641.407, the federal share of project costs is limited to "90 percent of the cost of any project which is the subject of an agreement entered into under the OAA" (with certain exceptions that are inapplicable here) and the non-federal share of costs, or required match, may consist of cash contributions, in-kind contributions, or a combination of the two. 20 C.F.R. § 641.407. The non-federal share is to be calculated in accordance with 29 C.F.R. § 97.24 [relating to grants to state or local governments] or 29 C.F.R. § 95.23 [discussed above with respect to OMB Circular A-110], as appropriate. 20 C.F.R. § 641.407.

Absent a waiver, the grantee is required to provide quarterly progress reports and, within 30 days of the end of each quarter a form SF-269, Financial Status Report (FSR), prepared on an accrual basis, with the final FSR to be submitted within 90 days after the end of the grant. 20 C.F.R. § 641.409.

"The grantee is responsible for the performance of all activities implemented under subgrant agreements and for compliance by the subgrantee with the OAA and this part." 20 C.F.R. § 641.410(a).

In addition to the above, regulations and manuals relating to the Job Training Partnership Act (JTPA) have been cited and analogized by both parties due to some

[36] Part 99 of 29 C.F.R. relates to audits for fiscal years beginning after June 30, 1996. ***See*** 29 C.F.R. § 96.12(b).

similarities between the two grant programs. Of particular interest are the JTPA provisions relating to stand-in costs. They will be discussed ***infra.***

DISCUSSION

At the outset, I note that summary decision may only be granted to the extent that there is no genuine issue of material fact. ***See*** 29 C.F.R. § 18.40; Rule 56, Fed. R. Civ. P. The findings below are based upon that standard.[37] To the extent that material factual issues remain on a pertinent issue, summary disposition is inappropriate and the matter must proceed to a hearing.

Finding No. 1

The rebates from Monumental under Section V(4) of the 1992 Agreement should have been credited to the Department of Labor under the grants as premium refunds.

The first issue concerns the appropriate treatment of payments from Monumental under section V of the 1992 Agreement, which the Grant Officer has characterized as "insurance refunds"or "premium refunds" and Complainants have characterized as "royalties." These payments are actually rebates made available to the Council on an annual basis based upon the amount of premiums collected and the claims paid, after taking into consideration expenses and appropriate contingency reserves. If they are "insurance refunds" under OMB Circular A-122, Attachment A, section 5.a., they will be treated as "applicable credits" and will be used to offset or reduce direct or indirect costs. On the other hand, if they are "royalties. . . for trademarks" under subsection (h) of section __.24 of OMB Circular A-110 and 29 C.F.R. § 95.24(e), Complainants have no obligation to the Federal Government with respect to program income earned from such source.[38]

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[37] In addressing the facts, I may consider Declarations, Deposition excerpts, and exhibits. ***See*** 29 C.F.R. § 18.40(d). However, the assertions contained therein will only be controlling to the extent that they are unrefuted by the assertion of "specific facts showing that there is a genuine issue of material fact for the hearing." 29 C.F.R. § 18.40(c).

[38] This provision is questionably relevant as it only applies to program income derived from royalties produced under an award. ***See*** 29 C.F.R. § 95.24(e). If the source of the payments were royalties **not** produced under a grant, ***a fortiori***, the Department of Labor would have no claim to them under the grant. ***See*** 29 C.F.R. § 95.24 (relating to program income). I reject the Grant Officer's suggestion to the contrary (***e.g.,*** AF-1 20, Motion at 31-32). Even if the definition of program income in 29 C.F.R. § 95.2(bb) were interpreted as requiring the payment of royalties not produced under a grant, such alleged "program income" would be earned after the end of the project period and the recipients would not have any obligation to the Federal Government with respect to it under 29 C.F.R. § 95.24(b). In contrast, any insurance refunds or rebates would be

(continued...)

There are actually two types of payments made by Monumental to the Council based upon the 1992 Insurance Agreement, as amended by the 1994 Royalty Agreement:

(1) The first type of payment (under section III(2) of the Insurance Agreement) relates to administrative functions performed by the Council itself and those transferred to Seabury and Smith under the Council's supervision (including premium collection and remittance), pursuant to sections II and III of the 1992 Insurance Agreement. Under section III(2), Monumental pays the Council 14.5% of earned premiums for these functions, and under a separate agreement Seabury and Smith is allocated 10.5% and the Council is allocated 4%.[39]

(2) The second type of payment (under section V(4) of the Insurance Agreement) relates to a calculation of a "Premium Refund" based upon the Aggregate Balance for the Retention Accounting Year (which ends on July 31). Under section V(4), a positive Aggregate Balance is returned to the Council as a "Refund," while under section V(5), a negative Aggregate Balance is transferred over to the next year as a "Deficit Accumulated." The Aggregate Balance (calculated under section V(3)(b)) is in turn based upon the Underwriting Results for the Retention Accounting Year less any Deficit Accumulated and adjusted for Contingency Reserves. Under section V(3)(a), the Underwriting Results for the Retention Accounting Year is calculated based upon the following formula:

Earned Premium
less Retention
<u>less Claims and Claim Reserves</u>
equals Underwriting Results for the Retention Accounting Year.

(AF-1 800). It is this second category of payments (which I have characterized as "rebates" or Section V(4) payments) that is being addressed here.

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[38](...continued)
considered as a "credit"or reduction of the allowable cost under section 5 of OMB Circular A-122 rather than as program income. ***See*** 29 C.F.R. § 95.2(bb)

[39] The Council is also responsible for marketing and advertising duties under section I, which consist of member solicitation and distribution of descriptive brochures and other promotional materials, and associated expenses may only be incurred by joint approval, under section V(1)(g). The associated advertising and marketing expenses under section I and a percentage of the administrative fees under sections II and III are reflected in the calculation of "Retention" under section V(1)(g), which in turn is used in calculating the Underwriting Results for the Retention Accounting Year and the corresponding Aggregate Balance under section V(3)(a) and (b).

At the outset, I reject Complainants' argument that the 1994 Royalty Agreement is controlling because it unequivocally labels the payments as royalties. The 1994 Royalty agreement is merely a modification of the 1992 Insurance Agreement and does not stand on its own, thereby requiring that both agreements be considered. As the 1992 Insurance Agreement refers to the rebates as "Premium Refunds" while the 1994 Royalty Agreement deems them to be "royalty fees," there is an ambiguity which requires further analysis.

This issue brings to mind the old syllogism, "if it looks like a duck, and it walks like a duck, and it talks like a duck, it's a duck." Quite simply, the payments concerned here, regardless of their label as "royalties" in the 1994 Royalty Agreement, or their label as "Premium Refunds" under the heading "Compensation" in the 1992 Insurance Agreement, are clearly partial premium refunds based upon favorable claims experience in the HIP program. An examination of the Section V(4) payments in the context of the detailed factual background set forth above makes it clear that these payments have all of the characteristics of partial premium refunds and none of the characteristics of royalties.

First, an examination of the history of the two types of payments discussed above makes it clear that payments under section V of the 1992 Insurance Agreement are partial insurance premium refunds rather than royalties.[40]

In this regard, when Monumental took over the HIP and Med. Supp. programs in 1988, it entered into two agreements with NCSC:

> (1) The first agreement was an Administrative Service and Marketing Agreement, pursuant to which Monumental assumed marketing and advertising responsibilities similar to those performed by the Council under section I of the 1992 agreement[41] and administrative responsibilities similar to those performed by the Council and Seabury under section II of the 1992 agreement.[42] Section 1(e) of the 1988 Administrative Services

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[40] Although the Grant Officer has argued that there is no need to consider prior agreements due to the unequivocal nature of the language in the 1992 Insurance Agreement, any such argument is negated by the presence of the 1994 "Royalty Agreement." The very existence of the latter document creates an ambiguity.

[41] Compare section 1(a) and (b) of the 1988 Administrative Service and Marketing Agreement with Section I(1)(a) and (b) of the 1992 Insurance Agreement. (AF-1787-88, 795-96).

[42] Compare section 1(c) through (k) of the 1988 Administrative Service and Marketing Agreement with section II(1)(a) through (i) of the 1992 Insurance Agreement. (AF-1787-88, 795-96). Section 1(e) "Collect and record premium payments" in the 1988 agreement addresses the use by Monumental of NCSC's mailing list and logo while section II(1)(c), its counterpart in the 1992 agreement does not, as those functions are being performed by Seabury under NCSC's

(continued...)

> and Marketing Agreement provided that Monumental would pay NCSC compensation under the schedule set forth in Exhibit A "as consideration for NCSC's marketing support services [performed by NCSC's membership development, membership record, and publication departments], which shall include but not be limited to Monumental's **use of NCSC's mailing list and logo for marketing purposes** and Monumental's right to promote insurance programs, through any and all NCSC publications and membership meetings, and for NCSC efforts to study and develop appropriate programs for senior citizens, and to reimburse NCSC for costs incurred therein." (AF-1 788). Under Exhibit A, effective August 1, 1988, Monumental was required to pay 4% of certificate holders' first year and renewal year earned premiums for both the HIP and Med. Supp. programs as "compensation for marketing support services." (AF-1 793). Section 2 of the Administrative Services and Marketing Agreement also indicated that the compensation payable to NCSC "shall not be contingent on claim experience." (AF-1 789).
>
> (2) The second agreement was the Retention Agreement, which calculated a "Premium Refund" based upon the results of a yearly "Retention Accounting" taking into consideration Earned Premium, less Retention, less Claims and Claim Reserves, in essentially the same manner as that utilized under section V(2) through (7) of the 1992 Insurance Agreement.[43] (AF1 782-84, 798-800). Thus, in contrast with the first agreement, yearly compensation under the Retention Agreement was dependent on claims experience.

It is clear that the payments under section III(2) have their genesis in the Administrative Service and Marketing Agreement, and that any compensation for the use of the Council's logo also falls within the purview of that section and is covered by the 4% of collected premiums retained by the Council out of the 14.5% of premiums paid under the section. It is also clear that the yearly payments made under section V(3), which are characterized as Premium Refunds in the 1992 Insurance Agreement, were also characterized as Premium Refunds in the 1988 Retention Agreement. Nowhere does the term "royalty" appear. ***See generally Texas Farm Bureau v. United States,*** 53 F.3d 120, 124 (5th Cir. 1995).

Thus, the 1992 Agreement unequivocally characterizes the payments concerned under section V(2) through (7) as Premium Refunds and their counterparts in the 1988

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[42](...continued)
supervision, pursuant to section III of the 1992 agreement.

[43] Compare sections 1 through 6 and 8 of the 1988 Retention Agreement with section V (1) though (7) of the 1992 Insurance Agreement. (AF-1 782-784, 798-800.)

agreements were also unequivocally characterized as Premium Refunds. The so-called "Royalty Agreement" executed in 1994 did not change the nature of these payments.[44] ***See In re Loop Hospital Partnership,*** 35 B.R. 929, 932 (Bankruptcy Ct. N.D. Ill. 1983) ("The parties cannot change the legal effect of an instrument simply by giving a name to it.")

Second, under the terms of the 1992 Insurance Agreement, Monumental did not retain any right to use the Council's name, logo, or mailing list as the marketing and administrative services were to be performed by the Council and Seabury.[45] Any use of the logo would necessarily be done by the Council and Seabury, in connection with the services for which they were to receive a flat rate of 14.5% of premiums collected under the two programs pursuant to section III of the 1992 Insurance Agreement, to be allocated by agreement.[46] In fact, unlike its 1988 counterpart, the portion of the 1992 Agreement relating to administrative services does not mention the use of the Council's logo either, nor does it mention royalty payments. Moreover, notwithstanding the assertion by Monumental's former Vice President Logan that the logo is valuable to Monumental in soliciting business (Logan Dec. ¶ 6), Complainants have cited no instances in which Monumental actually used the NCSC logo for any purpose during the periods concerned here. This is not surprising in view of the fact that under the 1992 Insurance Agreement, Monumental was no longer responsible for the marketing support services that utilized the logo or mailing lists.

Third, an analysis of the mechanism by which the rebates are calculated – which depends in large part upon claims experience – lends support to the Grant Officer's argument that they are indeed premium refunds. The dollar amount of premiums collected (earned premiums) and the dollar amount of claims paid (during the pertinent year) are prominent features in the formula, which also allows for adequate contingency reserves to ensure that future claims will be paid. The Grant Officer has cited cases which address

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[44] Although section V (3), (4), (5), (6), and (7) payments were deemed to be "royalties" under the 1994 Royalty Agreement, there was no substantive change to the provisions of the 1992 Insurance Agreement made at that time. (AF-1 808).

[45] The Myint & Buntua auditor, Melvin Weiser, acknowledged that if NCSC had provided Monumental with a mailing list and Monumental solicited those members at its own expense, then the fee paid to NCSC could be called a royalty. (Weiser Dep. p. 250-51). When asked essentially the same question later, he waffled. (Weiser Dep. p. 279-85).

[46] As the marketing services were performed by the Council itself (with Seabury's assistance) and as the name and logo were not directly used by Monumental, the payments under section III cannot be characterized as royalties either. ***See generally Sierra Club, inc. v. Commissioner, Internal Revenue Service,*** 86 F.3d 1536 (9th Cir. 1996). That issue is not, however, before me. As discussed with respect to Finding No. 2 ***infra***, neither party has made that argument.

similar retention agreements and provide for the refund of surplus or excess reserves to policyholders. ***See, e.g., American College of Surgeons v. Lumbermens Mutual Casualty Company,*** 491 N.E. 2d 1179, 1182 (Ill. App. 1986). Similarly, Bond Beebe's conclusion that NCSC received the alleged "royalty payments based upon NCSC's good experience rating" also supports the Grant Officer's argument that they are insurance premium refunds and not royalty payments. Experience rating systems have been used by commercial insurers to price insurance premiums based upon a group's claim experience for a particular period. ***NYS Health Maintenance Organization Conference v. Curiale,*** 64 F.3d 794, 796 (2d Cir. 1995). That such adjustments are made in the form of a refund as opposed to a reduction in future premiums does not change their essential nature.

Fourth, the payments do not satisfy the definition of "royalty." In this regard, Complainants' reliance upon ***Sierra Club Inc. v. Comm'r Internal Revenue Services***, 86 F.3d 1526 (9th Cir. 1996) is misplaced. In that case, the Tax Court had found that both rental fees for the use of the Sierra Club's mailing list and fees for the use of the Sierra Club logo in a credit card program constituted untaxable royalties rather than unrelated business taxable income. The U.S. Court of Appeals for the Ninth Circuit affirmed the Tax Court on the mailing list issue but remanded for consideration of whether income from the credit card program was "passive," based upon whether the Sierra Club had performed any services in the program for which payment was being made. The Ninth Circuit stated that the term "royalty" includes payments for the right to use intangible property rights and not payments for services, and is by definition "passive" in nature. It further noted that the term "commonly refers to the payment to an owner of property for permitting another to use the property" typically based upon a percentage of profits or a specified sum per item sold.[47] ***Id.*** at 1531. To say that the payments under either section of the 1992 Agreement were for the use of intangible property rights as opposed to premium refunds begs the question. The focus of ***Sierra Club*** was upon the issue of whether the disputed payments constituted taxable income, not whether they were premium refunds, so the case has limited precedential value here.

Finally, I am not persuaded by Complainants' argument that deference should be given to the opinions of their consultants and advisors that the payments are appropriately characterized as royalties.

In this regard, Complainants' reliance upon the findings of their auditors is misplaced. Significantly, the Department of Labor is not bound by the findings of the audits and, under section 215(a) of OMB Circular A-133, retains the right to conduct or

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[47] Payments made under section III of the 1992 Agreement would also not qualify under this definition. Unlike the earlier Administrative Service and Marketing Agreement that section III replaced, Monumental no longer "use[d] the property" (i.e., logo and mailing list) of the Council and the Council and Seabury performed the services under the 1992 Agreement.

arrange for additional audits. It did so here. The Department's own auditors (Myint & Buntua) reached a different conclusion and found the payments to be premium refunds.

Moreover, a review of the statements by the auditors at Bond Beebe (which performed the Single Audit Act audits of the Council from 1993 to 1996) and Thomas Havey LLP (which did the tax returns for the Council for 1997 through 1999 and the Single Audit Act audit of the Research Center for 1997) indicates that the auditors merely accepted their clients' characterization of the payments as "royalties." In fact, Bond Beebe – which prepared the financial statements and tax returns for the first two IG audit periods, in addition to performing the single audit reports – did **not** list any payments as royalties either on the 1993 tax return (relating to the fiscal year ending June 30, 1994) or on the financial statement for that fiscal year, even though General Counsel Mozer indicated that there were "royalties" for that year in the amount of $100,000.[48] The payments were, however, listed as royalties on both the financial statements and tax returns for subsequent years. Mr. Brown, the principal at Bond Beebe, provided no explanation for this discrepancy in his Declaration, although he stated that the payments had been properly reported as "revenue." Mr. Brown also went on to describe an "investigation" that Bond Beebe conducted at an unspecified time period following which it "concluded that NCSC received the royalty payments based on NCSC's good experience rating." This statement is a non sequitur, as it is premised upon the unsupported assumption that rebates based upon favorable claims experience may be characterized as "royalty payments." The unmistakable conclusion is that there was a change in the way these payments were reported beginning in fiscal year 1995 solely based upon the language used in the 1994 Royalty Agreement and that Bond Beebe unquestioningly accepted its client's revised terminology.

Similarly, the essentially conclusory statements by Complainants' former general counsel, Mr. Mozer, and by Monumental's former vice president, Mr. Loren, are not persuasive, notwithstanding their direct involvement. Their conclusions lack an articulated reasoned analysis except for a contemporaneous opinion prepared by Mr. Mozer and sent to Monumental in December 1994 (appearing at tab 12 of the Grant Officer's Appendix, Volume 2). That opinion is not persuasive as it is premised upon the assumption that

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[48] Upon review of the financial statements, it appears at first blush as if the $100,000 rebate is buried somewhere in the FY 1994 financial statements and income tax return, but that in FY 1995 the amount of $1,800,000 became a 200-pound gorilla that was too big to hide. The order and naming of the items of revenue changed between the two years, giving an impression of intentional obfuscation. However, after reviewing the depositions taken and the attached exhibits, it is clear that due to varying reporting periods and timing of drawdowns from the Special Holding Fund, it is difficult to compare the rebates during different years. (See Terrell Dep. Ex. 5, 7; Salgado Dep. Ex. 22). The one thing that is clear, however, is that nowhere was the November 1, 1993 drawdown of $100,000 (Salgado Dep. Ex. 22) reported as a royalty or even separately reported.

Section V of the 1992 Agreement "involves possible payments to NCSC for the use of its name and logo in solicitation of insurance to its members," a conclusion that is at odds with the facts discussed above. (App. vol. 2, tab 12).

Complainants' reliance upon the conclusions by the Internal Revenue Service are also misplaced. As the Grant Officer has argued, the IRS audits were conducted for an entirely different purpose, with the focus of the inquiry being whether the income of a nonprofit organization was "passive" and was therefore not taxable as compensation for services (***i.e.*,** unrelated business income) under ***Sierra Club, supra***. Moreover, as discussed above, the information provided to the IRS under the record before me appears to have been incomplete and possibly misleading, as it omits reference to the bearing that premium receipts and claims experience had upon the yearly "royalties." In this regard, the IRS's conclusion that "the insurance program with Monumental Life Insurance, is operated **without services being rendered** by the organization [NCSC]" (Hallberg Dec. Ex. B) is contrary to the undisputed facts before me, and suggests that the IRS was not provided with all relevant information. In any event, I am not bound by the IRS determination.

Based upon the above, I find that the rebates under section V of the 1992 Agreement and the 1994 Royalty Agreement are in the nature of insurance premium refunds, rather than royalties. Accordingly, to the extent that they are program-related, they should be treated as a credit to offset program costs.

In view of this finding, it is unnecessary to address the Grant Officer's arguments that even if the payments were deemed to be royalties, they would be subject to crediting to the grant as program income.[49] I have found to the contrary that they may **not** be considered royalty payments. The alternate basis suggested by the Grant Officer is therefore moot.

The credits to the grants should be based upon the amounts allocable to the HIP premiums paid on behalf of senior aides and should be limited to the amounts actually received or subject to drawdown.

In disallowing costs relating to the HIP program under the grants, the Grant Officer adopted the approach taken by the auditors, which was to go beyond the amounts actually received as rebates.[50] Instead, the Grant Officer ignored the amounts actually

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[49] The Myint & Buntua auditor Melvin Weiser stated that no matter how you categorized them, the amounts received from Monumental were not program income. (Weiser Dep. p. 279).

[50] As used herein, "rebates" references the payments made under section V of the 1992 Insurance Agreement and 1994 Royalty Agreement, which Complainants allege were royalties and

(continued...)

withdrawn from the special holding account by the Council and disallowed the amount that the auditors calculated **would have been** paid or payable if the HIP program had stood alone. In this regard, the Government stopped paying the premiums for Med. Supp. insurance held by senior aides in December 1992 so all Med. Supp. enrollees thereafter were either NCSC members or senior aides who paid their own premiums outside of the program. Certainly, it would be acceptable to allocate the costs between the Federal and non-Federal portions of the programs, and to therefore allocate the rebates in a corresponding manner. However, I find no basis for directing the Complainants to repay rebates that they did not receive, and were not entitled to, but which they **might have** received, and might have been entitled to, if they had entered into a **different** agreement with Monumental. ***See*** OMB Circular A-122, Attachment A, section A.5.a. (defining applicable credits as "receipts or reductions of expenditures which operate to offset or reduce expense items" and providing for their use as a cost reduction or cash refund "[t]o the extent that such credits **accruing or received** by the organization relate to allowable costs"). As Complainants have suggested (Reply at p. 19), the Grant Officer has attempted to retroactively rewrite the agreements between NCSC and Monumental, and I reject such an attempt. It would be speculative to assume that the HIP program could be extricated from the Med. Supp. program for the purpose of determining what rebates would have been paid if the HIP program had stood on its own. The better performance of the plan for senior aides may be due to other factors (such as the "healthy worker effect" noted by epidemiologists) rather than a result of premiums being too high in the HIP program as compared with the Med. Supp. program. In fact, the two programs were initially operated within the same profit margin, as discussed ***infra***. Moreover, the pertinent provisions of the 1992 Agreement dated from a time when premiums were paid for senior aides in both the HIP and Med. Supp. programs, so there was nothing inherently unreasonable about linking the two programs, as had been done historically, nor was there any inappropriate "commingling" of funds.

With that being said, it is reasonable to determine what portion of the rebates **actually paid** (***i.e.***, actually drawn down or subject to being drawn down under the 1992 Agreement's retention formula) were allocable to insurance premiums paid by the federal government for the senior aides' HIP coverage. For that purpose, any rebates from the Med. Supp. program would have to be excluded, as would that portion of the HIP rebates based upon members who were not employed as senior aides.[51] As the chart reproduced

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[50](...continued)
the Grant Officer alleges were insurance refunds. For the reasons stated above, I have found that the rebates were insurance premium refunds.

[51] Although EPA also operates a program relating to seniors (the Senior Environmental Employment [SEE] program) for which NCSC/NSCERC is one of the grantees, health insurance coverage is provided under an EPA sponsored plan, designed by CIGNA. (AF-1 589, 944). Thus, (continued...)

in the Statement of Facts above shows, the Med. Supp. program generated deficits and no rebates for the first three years from August 1992 to July 1995 and then generated a gain from August 1995, after which the Med. Supp. program was discontinued and generated neither losses nor gains. (See also Weiser Dep. Ex. 2). Overall, the Med. Supp. program generated a cumulative loss and absent its connection with the HIP program, it does not appear that any rebates would have been paid. During the same period and thereafter, the HIP program consistently produced gains, leading to the rebates. Over 90 percent of the HIP enrollees were senior aides, but none of the Med. Supp. enrollees were paid under the grants.[52] (Weiser Dep. pp. 128-49). However, the HIP enrollees who were not covered by the grants reportedly had a worse claims experience than the senior aides. (Weiser Dep. p. 142-43, 147, 402-11, 444-46). Thus, it would be reasonable to credit **all** of the rebates **actually received** (or accrued and subject to draw down under the retention formula) to the grant program.

Based upon the above, it is also my view that rebates allocable to the HIP program would be required to be returned to the subject grants, even if the amounts were drawn down after the expiration of the grant periods. The summary appearing in the Statement of Facts above suggests that sizable amounts were withdrawn after the grant periods, which would also be allocable to the subject grants as insurance premium refunds. As the parties have not addressed that matter, however, and as there has been no agreement as to the amounts or derivation of these later draw downs, it does not appear that this issue is even before me. In any event, the matter cannot be resolved by summary disposition.

NSCERC cannot be required in this forum to pay back rebates it never received except for those rebates relating to the first two audit periods, relating to Fiscal Years 1993 to 1996, which are within the purview of the Novation Agreement.

It is undisputed that the rebates were received by the Council and not the Research Center. Thus, the Research Center cannot be required to pay the disputed amounts unless there is some other basis for requiring their payment. ***See*** OMB Circular A-122, Attachment A, section 5.a. (requiring credits to grant for amounts relating to allowable costs that have been accrued or received). [53]

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[51](...continued)
the HIP plan rebates are not related to the EPA grant.

[52] It appears that on page 131 of Mr. Weiser's deposition, the two programs were confused, but the matter was clarified later. (Weiser Dep. 131, 134).

[53] The parties have not addressed whether or to what extent the United States may proceed against either the Council or the Research Center, or both of them, in a different forum.

The Grant Officer has taken the position that the Council and the Research Center are jointly and severally liable and are both responsible for repayment of the rebates by virtue of the Novation Agreement executed in 1996. (Grant Officer's Motion for Partial Summary Decision at 49 to 50; AF-2 282-284, 284(a)-285). As noted above, the United States was a party to the Novation Agreement, pursuant to which responsibility for the contracts relating to Grant #D-5102-5-00-81-55 (including all obligations and liabilities under the contracts) was transferred from the Council as Transferor to the Research Center as Transferee, in view of legislative changes which proscribed lobbying non-profit organizations (such as the Council) from receiving grant funds of this magnitude. The Novation Agreement specifically provides, in section (b)(2):

> (2) The Transferee [the Research Center] agrees to be bound by and to perform each contract in accordance with the conditions contained in the contracts. The Transferee also assumes **all obligations and liabilities** of, and all claims against, the Transferor [the Council] **under the contracts** as if the Transferee were the original party to the contracts.

(AF-2 283, 284(a).) Likewise, under section (b)(8) of the Novation Agreement, "the Transferor [the Council] guarantees payment of all liabilities and the performance of all obligations that the Transferee [the Research Center] (i) assumes under this Agreement or (ii) may undertake in the future should these contracts be modified under their terms and conditions." (AF-2 285). However, the Novation Agreement only relates to the grant for fiscal year 1996. In addition, while the Novation Agreement was adopted as a modification to that grant contract, no similar modification related to any of the other grants.

The Grant Officer argues in his Motion for Summary Disposition at pages 49 to 51 that the term "contracts" in the Novation Agreement relates to all of the grant contracts and that both NCSC and NSCERC are therefore jointly and severally liable for each grant period. In this regard, section (a)(1), the pertinent section in the Novation Agreement, provides:

> (1) The Government, represented by various contracting officers of the United States Department of Labor, has entered into certain contracts with the Transferor [the Council], namely Grant #D-5102-5-00-81-55. The term "the contracts," as used in this Agreement, means **the above contracts and purchase orders and all other contracts and purchase orders**, including all modifications, made between the Government and the Transferor **on or before the effective date of this Agreement** (whether or not performance and payment have been completed and releases executed if the Government or the Transferor has any remaining rights, duties, or obligations under these contracts and purchase orders). Included in the term "the contracts" are also **all modifications made** under the terms and

conditions of these contracts and purchase orders between the Government and the transferee, **on or after the effective date of this Agreement**.

Although the Agreement references the fiscal year 1996 grant in particular, and the associated modification related only to the 1996 grant, the language "the above contracts and purchase orders and all other contracts and purchase orders" "made . . . on or before the effective date of this Agreement" can only reflect the intention of the parties to include all of the prior grants relating to the SCSEP program. With respect to any contracts entered into after the Novation Agreement, only modifications are included. Thus, while the Research Center is a party to the third audit period, the Novation Agreement addresses contract modifications relating to the 1996 grant which it modifies but cannot, and does not, address future contracts or grants for future years. The contracts covered by the third audit period do not incorporate, and are not covered by, the Novation Agreement.

In view of the above, the terms of the Novation Agreement make the Research Center liable for the Council's obligations and liabilities for the first two audit periods, and they also make the Council the guarantor of the Research Center's performance for those periods. Under section (b)(2) of the Novation Agreement, the Research Center has adopted all of the Council's obligations and liabilities for the grant period and prior grant periods. Under OMB Circular A-122, Attachment A, section 5.a., the Research Center is therefore liable for premium refunds received by the Council relating to the grant periods for fiscal years 1993, 1994, and 1995 (the first audit period) and fiscal year 1996 (the second audit period) by virtue of the Novation Agreement. Under section (b)(8), the Council is also liable as guarantor for both of these audit periods.

Complainants argue that there no subject matter jurisdiction for me to consider joint and several liability of the parties based upon the Novation Agreement because, although it was adopted as a modification of the grant contract for fiscal year 1996, there was no finding of joint and several liability in the Final Determination relating to that grant or in any of the other Final Determinations.[54] (Complainants' Response at 30, Comp. Reply at 21- 22).

With respect to the first audit period, Complainants argue that no such finding could be made because the Research Center is not even a party and the Novation

[54] I agree with the Grant Officer that Complainants' reliance upon ***Hitek Learning Systems, Inc. v. South Carolina Employment Security Comm.***, 2001-JTP-0002 (OALJ, Jan. 25, 2002) is misplaced. In that case, the undersigned administrative law judge dismissed an appeal by a JTPA grantee for lack of jurisdiction when no final determination had been issued and there had been no showing of facts upon which jurisdiction could be premised upon either of two jurisdictional bases. That case is distinguishable from the instant case in that a final determination has been issued here.

Agreement is not even part of the Administrative File. (Comp. Response at 30, Comp. Reply at 21). I do not, however, find this factor to be determinative, as the audit relates to the grants as a whole. Here, there was a transfer of contractual obligations to the Research Center by virtue of the Novation Agreement, to which the United States was a party, and all parties were given notice. It is to be contrasted with cases in which the successor contractor did not receive notice. ***See generally Riggers v. Argus Systems, Inc.,*** 1998-MIS-1 (ALJ Order of Remand, Jan. 29, 1998) ***following remand***, ARB No. 99-006 (ARB, Oct. 13, 2000) (case remanded by ALJ when alleged successor contractor under Executive Order 12933 did not receive notice, no investigation was conducted, and no final determination was issued.) This case is also to be contrasted with contract cases in which there is no privity of contract between the government and the party sought to be joined. ***See generally Garrett, Sullivan & Company v. U.S. Dept. of Labor***, 1986-BCA-8 (Bd. of Contract Appeals March 12, 1987) (joint and several liability not available and matter is not ripe for adjudication when party sought to be joined has no privity of contract with the Government).

Complainants further argue that the pertinent regulations limit review by an administrative law judge to findings made in the final determination for which review has been sought (citing 20 C.F.R. § 641.415(b), which in turn references 29 C.F.R. Part 96, and the provisions now appearing at 20 C.F.R. § 96.63). In response, the Grant Officer asserts that the cited provision merely limits the issues that may be litigated on appeal and does not address jurisdictional issues. The Grant Officer asserts that it does not prevent this tribunal from addressing "the issue of liability between the NCSC and NSCERC and the applicability of the Novation Agreement which is an inextricable part of the question of whether NCSC and NSCERC are liable for these cost disallowances." The Grant Officer also notes that both entities were on notice of their potential joint liability and have not been prejudiced. (Grant Officer's Reply at 13 to 16).

I agree with the Grant Officer that the cited provision does not limit my jurisdiction. In ***Brock v. Pierce County,*** 476 U.S. 253 (1986), the U.S. Supreme Court addressed a provision in the Comprehensive Employment and Training Act (CETA) (the predecessor to JTPA), which required the Secretary of Labor to issue a final determination concerning the misuse of grant funds within 120 days after receipt of a complaint. The Supreme Court found the requirement not to be jurisdictional, noting that it was meant to spur the Secretary to action, not to limit the scope of the Secretary's authority. ***Id.*** at 265. ***Accord, Barnhart v. Peabody Coal Co.,*** 123 S.Ct. 748 (2003).

Complainants also argue that even assuming, ***arguendo,*** that pursuant to the Novation Agreement, the Research Center assumed all "obligations and liabilities of, and all claims against" the Council, the Novation Agreement was not by its terms applicable to future claims. Thus, they maintain that as the audit in this case was not commenced until after execution of the Novation Agreement, the audit disallowances may be characterized as "future claims, liabilities, or obligations" and are not covered under the Novation

Agreement. (Complainant's Response at 31 to 32.) I disagree with this interpretation, particularly as applied to the second audit period. If the Novation Agreement did not apply to future disallowances under audits of the grant period to which it relates, it would have no effect and the Federal Government would have no recourse for the misappropriation of grant funds. Such a result would be at odds with the intent of the agreement.

The Grant Officer does not argue that the Novation Agreement should be applied to the last audit period. However, the Grant Officer notes (Grant Officer's Reply at 13) that the Research Center is directly liable under the second half of the second audit period and the third audit period as it was the sole grantee. It does not, however, necessarily follow that it should be responsible for payment of the insurance refunds relating to those periods, as it never received such refunds. In this regard, the Grant Officer argues that the Research Center should be held responsible due to "[i]ts acquiescence to the diversion of federal funds to and by NCSC" which "makes it as liable for these misspent funds as if it had received these premium refunds itself." (Grant Officer's Response at 23). The Grant Officer does not cite authority supporting this proposition but, in any event, the issue of whether the Research Center acquiesced in the diversion of federal funds is a factual issue inappropriate for summary disposition.

I also do not find that the Novation Agreement provides authority for holding the Council liable with respect to rebates related to the contracts for the third audit period. While the Novation Agreement applies to future modifications of the FY1996 contract, it does not apply to new contracts.

The Council has been named as a party in all three cases. Complainants have not argued that there is no jurisdiction over the Council with respect to any of the three audit periods.

There is an issue of material fact as to whether the insurance premiums for the HIP program were inherently unreasonable.

The Grant Officer argues that the HIP premiums themselves were excessive and should have been disallowed on that alternative basis. (Motion at 26 to 30). No such finding appears in the three audit reports, although the Grant Officer asserted that the premiums were excessive in the final determinations.

With respect to the Council, the issue is of limited significance, as I have found that the rebates must be returned as premium refunds. Moreover, the suggestion that the premiums were excessive is primarily based upon the latter audit periods.[55]

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[55] It was not initially apparent that the HIP program would generate large rebates. At his (continued...)

The issue is, however, somewhat different for the Research Center, as it paid HIP premiums for senior aides during the grant periods beginning in 1996. At the time the Research Center took over responsibility for the grants, the two programs together were consistently generating large surpluses yearly, and the bulk of the payments were based upon the HIP program. Under these circumstances, the inference could be drawn that the premiums for the program may have been excessive, warranting a reduction in the future. However, this assertion has been disputed by Complainants and they have submitted evidence supporting their claim that the premiums charged were not excessive when compared with comparable programs. Under these circumstances, there are material factual issues relating to the determination of whether the premiums should have been disallowed as excessive, and the issue will not be resolved on summary disposition. ***See*** 29 C.F.R. § 18.41(a) (requiring no genuine issue of material fact for summary disposition.) A hearing will be required on this issue, to the extent that it remains relevant.

Stand-in Costs.

The rejection of the proposed Stand-in Costs on the basis that they were unallowable "donations" under OMB Circular A-122 was invalid, as was their rejection on the basis that they were incurred by subgrantees.

"Stand-in costs" are not defined in the regulations relating to the Older Americans Act SCSEP grants. However, they are defined in the regulations relating to another grant program administered by the Department of Labor, the now-defunct Job Training and Partnership Act (JTPA) grant program,[56] appearing at 20 C.F.R. § 626.5 (2002):

> *Stand-in costs* mean costs paid from non-Federal sources that a recipient proposes to substitute for Federal costs that have been disallowed as a result of an audit or other review. In order to be considered as valid substitutions, the costs (1) shall have been reported by the grantee as uncharged program costs under the same title and in the same program year in which the disallowed costs were incurred (2) shall have been incurred in compliance with the laws, regulation, and contractual

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[55](...continued)
deposition, Edwin Terrell, Jr., a DOL auditor who supervised the audits, indicated that during the course of meetings he learned that the premium for the HIP program had been set back in 1988 and had not increased despite inflation, and he also learned that back in 1992 both the HIP plan and the Med. Supp. plans were generating similar gains, although they varied widely on a yearly basis. (Terrell Dep. p. 74-75, 154-59, 184-85, Ex. 3). However, he also learned that Monumental had never heard of NSCERC and that the decision not to reduce the rate was made by the administrator (NCSC/NSCERC). (Terrell Dep. p. 76, 90-92 Ex. 3)

[56] JTPA was replaced by the Workforce Investment Act of 1998, 29 U.S.C. § 2801 ***et seq.***

provisions governing JTPA, and (3) shall not result in a violation of the applicable cost limitations.

This definition is echoed in the regulatory provisions relating to Administrative Standards, in the section relating to Audits, appearing at 20 C.F.R. § 627.480(f) (2002). That section requires that for a recipient to propose the use of stand-in costs as substitutes for otherwise unallowable costs, the proposed stand-in costs must have been "reported as uncharged JTPA program costs, included within the scope of the audit, and accounted for in the auditee's financial system," must be "from the same title, and program year as the costs which they are proposed to replace," and must "not result in a violation of the applicable cost limitations." ***See also Commissioner, Employment Security of the State of Washington v. U.S. Dept. of Labor,*** 1990-JTP-29, 1991-JTP-11, 1992-JTP-34 at p. 6, note 4 (Sec'y, Sept. 13, 1995). All of the above criteria are included in the JTPA Financial Management Manual of January 6, 1995 (excerpted at Tab 13 of the Grant Officer's Appendix), in addition to the requirement that the stand-in costs be documented in the same manner as all other program costs.[57] When the regulations themselves were amended in 1994, the Employment and Training Administration (ETA) at DOL rejected suggestions that stand-in costs be allowed as substitutes regardless of the year or program/title that generated them. It explained that such a proposal "runs counter to the intuitive concept of substituting to make whole the program that bore the cost of the misexpenditures" and is "contrary to ETA's interpretation of the General Accounting Office (GAO) Comptroller General decision which is the basis for the position on 'stand-in' costs." 59 Fed. Reg. 45815 ***et seq.*** (Sept. 2, 1994).

The Comptroller General decision referenced in the JTPA regulations is Comptroller General Opinion B-208871, B-208871.2, 68 Comp. Gen. 247, 1989 WL 237492 (Comp. Gen. Feb. 9, 1989) (appearing in the Grant Officer's Appendix at Tab 4). In that decision, a contracting officer asked the Comptroller General "whether a contracting officer or grant official may, at his discretion, refuse to allow valid costs submitted as substitute costs for previously disallowed costs as long as the total amount allocated to the contract is not exceeded." The Acting Comptroller General determined that the official lacked such discretion and concluded that "where funds remain available under a grant or contract as a result of disallowed costs, a grantee or contractor may submit other grant or contract costs as substitutes and these costs should be paid if otherwise allowable, up to the maximum amount authorized by the contract or grant." The situation presented involved cost-plus-fixed-fee contracts, with excess costs to be

[57] While not a regulation having the force and effect of law and relating to a different program, the JTPA Financial Manual is relevant as an interpretive aid. In fact, the JTPA Financial Management Guide was one of the resources consulted by Richard Lance Grubb, the Director, Office of Grants and Contracts Management of ETA, who reviewed and rejected the proposed stand-in costs. (Grubb Dec. ¶1 [Grant Officer's Appendix, Volume 2, Tab 20]; Grubb Dep. p. 52.)

substituted for disallowed costs, but the decision makes clear that it is also applicable to grants. The decision stressed that the substituted costs must be allowable, referencing OMB Circular A-122.[58] It also noted that the issue was "not one of debt collection" because "[t]he substitute costs must be viewed as part of the totality of allowed and disallowed costs, which occurs at the audit resolution phase before a collectible debt is established."

The JTPA Financial Management Manual excerpt appearing at Tab 13 of the Appendix provides an illustrative example:

> **Caution.** Stand-in costs cannot be fabricated using circumstances or conditions that appear to be legitimate liabilities if no actual costs are incurred **by any entity**. For example, the local School Department provides free space for the JTPA program in a building that has been fully depreciated. The only facility-related costs the School Department actually pays are for general maintenance. A liability created by JTPA related to rental costs that were never paid is not a legitimate stand-in cost. The only legitimate stand-in cost available in this example assuming that all recording and reporting requirements have been satisfied, is **an allocable share of the general maintenance cost** based on square footage occupied, or another allocation method that would be more equitable.

JTPA Financial Management Manual Chapter 11, page 15 (appearing at Tab 13, Grant Officer's Appendix.) The Manual goes on to note that while certain costs may be substituted for disallowed costs, the source of such stand-in costs "is intended to be limited to the same entity which incurred the disallowed costs" and "aggregation or pooling of stand-in within a state as a kind of insurance policy available to reduce or extinguish bad costs" is not allowed, nor is substitution allowed when the disallowance was due to fraud.

Although not necessarily using the term "stand-in costs," other tribunals have recognized the principle that other allowable costs may be substituted for costs disallowed under a grant program. For example, in ***Institute for Technology Development v. Brown,*** 63 F.3d 445, 450 (5th Cir. 1995), the U.S. Court of Appeals for the Fifth Circuit indicated that depreciation of a building (to the extent allocable to a grant) could be claimed as an allowable cost and substituted for disallowed costs. Although indicating that whether a cost was allowable depended upon the grant terms, the Court reasoned that depreciation was a recognized cost under OMB Circular A-122, which was applicable to the grant (as it is to the instant grant). ***Id.***

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[58] Pertinent provisions of the Circular are excerpted above.

In considering the matter at hand, I will first address the Grant Officer's argument that the stand-in costs must be rejected because they were "donations" within the meaning of OMB Circular A-122. That particular Circular prevents donated services, goods, and space from being reimbursed as allowable costs.

Although the Grant Officer initially took the position that it was undisputed that the excess match amounts were donations (Grant Officer's Motion for Summary Decision at 36), that is incorrect.[59]

A review of the grant agreements in the instant case indicates that, as budgeted, it was contemplated that the administrative fees for headquarters (the Council and later the Research Center) would be entirely covered by the Federal share and that the local administrative fees would be entirely covered by the non-Federal share; the local administrative fees budgeted were the 10% non-Federal share. (AF-1 189, 223; 449-50; 310-11; AF-2 168-69; AF-3 322, 391; 200, 312.) [60] However, while requiring that Complainants ensure that the total of local non-federal contributions amount to no less than 10 percent of the cost of the program, the grant agreements do not indicate how excess local administrative fees would be treated.

As discussed above, the SCSEP grants required that Complainants match the federal contribution by paying 10% of the total project costs from non-federal sources. (Gallagher Dec. ¶ 6). In accordance with this requirement, each subrecipient submitted periodic funding requests for reimbursement of the federal share of its costs on Form SA1s, "Sponsor's Request for Funding." (Gallagher Dec. ¶¶ 7 to 9 and Ex. 1). The subcontractors periodically reported their program costs on the grantee's Form SA1-A, "Sponsor's Detailed Statement of Costs," which indicates the actual incurred program costs paid with non-federal funds, broken down as Cash Component (cash payments for direct program costs), Indirect Component (cash payments for indirect program costs), and In-Kind Component (fair market value of donated property or volunteer services.) (Gallagher Dec. ¶¶ 7 to 12 and Ex. 1 and 2).[61]

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[59] In reaching this conclusion, the Grant Officer has misquoted a table with associated footnotes appearing in the Administrative File for the second audit. (Motion at 36). That table summarizes the cash, indirect cash, and in-kind components of non-federal costs, as defined in the footnotes. (AF-2 347). The excess match calculated and reported on Complainants' books (see the Statement of Facts above) was based upon the amount of non-federal cash payments (both direct and indirect) minus one ninth of the amount paid by the Federal Government.

[60] "A local project sponsor agency must be able to provide a cash or in-kind contribution for some or all of the administrative costs of a project." (AF-1 349; see also AF-3 259-60).

[61] In the JTPA Financial Management Manual example appearing above, the estimated fair rental value of the donated building would be an in-kind contribution while the portion of

(continued...)

While the conclusions of auditors do not constitute undisputed facts, some of the testimony of the auditors sheds light on the way these types of costs have been addressed.

In this regard, the Director, Office of Grants and Contracts Management of ETA, Richard Lance Grubb, explained the basis for which he rejected the stand-in costs as "donations":

> 5. I determined from my review of this representative sample [of proposed stand-in costs from six of approximately 150 subrecipients] that the proposed stand-in costs submitted by NCSC and NSCERC were excess matching funds incurred by the subrecipient Sponsors. These costs, both the original matching funds and the excess matching funds, were administrative costs donated to the grant by the subrecipients. Under the agreements between the subrecipients and NCSC and NSCERC, these funds were not reimbursable under the SCSEP grants. . . .[62]
>
> 6. As donations, these costs are not allowable and reimbursable under OMB Circular A-122, Attachment B, Section 10.a.(1) (now codified at OMB Circular A-122, Attachment B, Section 12.1.(1), see Tab 1), which specifically provides that "[d]onated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and skilled and unskilled labor. The value of these [donated] services is not reimbursable either as a direct or indirect cost." Therefore, they are not usable as stand-in costs and may not be substituted for the disallowed costs under this program.

(Grubb Dec. ¶¶ 5, 6 [Grant Officer's Appendix Vol. 2 at tab 20].) Upon questioning at his deposition, Mr. Grubb contended that because the proposed stand-in costs were paid by the subrecipients, not by NCSC, they could not be claimed by NCSC. (Grubb Dep. p.

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[61](...continued)
maintenance costs paid that is allocable to the grant would be cash program costs (either direct or indirect, depending upon whether the maintenance costs were part of overhead).

[62] Myint and Buntua auditor Melvin Weiser made a similar statement but was unable to cite to any agreement so providing. (Weiser Dep. at 552-58, 563). The sample agreements submitted by the Grant Officer in the Appendix at tabs 6 and 7 do not include such a requirement. However, the NCSC Senior AIDES Policy and Procedures Manual prohibits Federal funds provided to sponsors from being "budgeted or expended for administrative costs." (AF-1 1244-45). This is consistent with the planned budget for the grants, under which it was assumed that the administrative costs would constitute the required non-federal match, but does not necessarily address the issue of whether such administrative costs in excess of match requirements could be substituted for disallowed costs.

56). He also indicated that the subrecipients were prohibited from claiming them based upon their agreement with NCSC. (Grubb Dec. p. 56).

Grant Officer Salgado adopted Mr. Grubb's analysis and rejected the proposed stand-in costs. (Salgado Dec. ¶¶ 3, 4, 5 [Grant Officer's Appendix Vol. 2 at tab 21].)

The Office of Inspector General supervisory auditor, Edwin M. Terrell, Jr.'s testimony also addresses this issue. When asked about a memorandum relating to NCSC's site visit at the Baltimore County Department of Aging and the associated forms SA1-A submitted by that entity, he indicated that the items reported on the SA1-A, relating to an allocation of the salaries of the Director and other personnel, were appropriately reported as part of the cash component of the match (as opposed to the in-kind component). However, he indicated that he was not familiar with the requirements of OMB Circular A-122. (Terrell Dep. p. 298-304).

Myint & Buntua auditor Melvin Weiser expressed his opinion that reimbursement of the stand-in costs would result in an "unjust enrichment" to NCSC, as they were not costs incurred by NCSC itself, but he, too, admitted he was not familiar with the regulatory standards. (Weiser Dep. p. 543-44).

Upon review of the authorities cited, taken in the context of the undisputed facts, I must reject the Grant Officer's analysis. In this regard, the subrecipients or subgrantees periodically reported to Complainants what amounts had been allocated to the grant and they were reimbursed for up to 90 % of the funds expended. The amount over the 10 % the grantee was required to put up constituted excess match funds. Thus, when reporting expenditures under the grant, the subrecipients indicated the amount of expenditures which were cash (funds directly expended on the grant), indirect (allocable amount of overhead), and in-kind (estimated value of donated property or volunteer services.) Cash expenses can, however, include the amount of an employee's salary paid by the subrecipient to the extent that the employee's services were devoted to the grant. Such payments are not donations, unless the employee is an unpaid volunteer. Similarly, if there were maintenance costs associated with donated property, they would be deemed to be cash expenses to the extent allocable to the grant. The JTPA Financial Management Manual, quoted above, makes it clear that such expenses are not donations within the meaning of the OMB Circular but are, instead, allowable costs for substitution under the Comptroller General decision. To the extent that the prohibition on reimbursement for donated services and property applies, it only applies to the in-kind component.

For the same reason, I reject the Grant Officer's rejection of all of the stand-in costs on the basis that the costs were incurred by the grantees, not the Complainants. This whole argument is premised upon who actually paid the costs, whereas stand-in costs, by definition, must be expended on the grant. There is no requirement for the stand-in costs to have been paid by the grantee itself, as opposed to a subrecipient, as long as they were actually expended on the grant during the year in which incurred.

The authority cited by the Grant Officer to support his interpretation – the JTPA Manual (App. Vol. 2 tab 13) – relates to a different program, is program specific, has not been adopted following notice-and-comment rulemaking, and does not appear in the JTPA regulations (compare 20 C.F.R. § 627.480(f)). (See Salgado Dec. ¶¶ 7 and 8). I agree with Complainants that the provision in the manual that restricts stand-in costs to "the same entity that incurred the costs" and disallows the pooling of costs is intended to apply to a state-wide program (such as JTPA) with more than one grantee (Complainant's Reply at 33); it does not prevent a grantee from substituting program costs incurred by different subrecipients and devoted to the same grant, to the extent that the costs are otherwise reimbursable.[63] As Complainants have pointed out, the grantee is the only entity that can report a subrecipient's stand-in costs because it is the only entity that reports directly to the Department of Labor. (Statement of Undisputed Facts (Stand-in Costs) ¶ 40.) Thus, a grantee such as the Council or the Research Center is not proscribed from substituting costs otherwise allowable under the grant, merely because they were a part of the grant paid by subgrantees in excess of match requirements.[64]

Finally, the Grant Officer argues that allowance of the stand-in costs would result in a "windfall" to Complainants because the excess costs were incurred by the subrecipients, not Complainants. (Grant Officer's Motion at 48). This is a matter that is between the subrecipients and Complainants and its resolution is not within my jurisdiction. ***See generally Garrett, Sullivan & Company v. U.S. Dept. of Labor,*** 1986-BCA-8 (subcontractors have no privity of contract with government.) Under the pertinent regulations, "[t]he grantee is responsible for the performance of all activities implemented under subgrant agreements and for compliance by the subgrantee with the OAA and this part" and it is only the grantee who has standing to appeal the final determination. 29 C.F.R. §§ 96.63(b); 641.410(a), 641.415. Under 29 C.F.R. § 96.61(b), "[s]ubrecipients and subcontractors shall have only such appeal rights as may exist in subgrants or subcontracts with the respective recipients or contractors."

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[63] It is worth noting that the bulk of the disallowed costs relate to credits based upon refunds of insurance premiums paid on behalf of senior aides employed by the subrecipients. (See, ***e.g.***, App. Tab 9).

[64] In the example provided in the JTPA Manual (quoted above), it is not explained whether the local School Department is a direct grantee or a subgrantee. Instead, the focus is upon whether **any** entity has incurred actual costs. Thus, the portion of general maintenance costs paid by the School Department and attributable to the grant is reimbursable (and subject to substitution for a disallowed cost), while the fair market value of the free rent is not.

In view of the above, I find that the rejection of the proposed stand-in costs on the basis that they were donations from subrecipients was not valid.[65]

There are factual issues as to whether all of the stand-in costs claimed were actually reimbursable costs under the grants preventing summary decision on the issue and possibly requiring remand to the Grant Officer.

The Grant Officer argues that if this tribunal rejects his argument that the proposed stand-in costs are unacceptable as "donations," remand is required because the proposed stand-in costs have not been assessed under the other criteria relating to allowable costs. (Grant Officer's Response at 34-35). In support, the Grant Officer has submitted the declarations of Mr. Grubb, the reviewer of Complainants' proposed stand-in costs, and Mr. Salgado, the Grant Officer, who explained that because the stand-in costs were rejected as "donations," the other factors required to be considered in order to determine whether the proposed costs were allowable, were not considered during the course of the audit. (Grubb Dec. ¶¶ 4 to 7; Salgado Dec. ¶ 4). These factors include whether the substituted costs were from the same grant year and whether they satisfy the cost limitations set forth in the OAA and the regulations. On the other hand, Complainants argue that summary decision in their favor is warranted because the Grant Officer's response is "generic and superficial" and is insufficient to rebut the evidence adduced by Complainants under the summary decision standard of 29 C.F.R. § 18.40. (Complainants' Reply at 26).

I agree with the Grant Officer that a remand is required. Stand-in costs are considered at the audit resolution phase, under the Comptroller General decision discussed above. Thus, while summary decision could have been granted in favor of the Grant Officer on this issue, if I had found the Grant Officer's rejection of such proposed costs to be appropriate, Complainants cannot prevail on the ultimate issue on summary decision. In this regard, the effect of my above finding in favor of the Complainants on the stand-in costs issue is to reopen the audit resolution phase of the proceedings and make the amounts disallowed no longer subject to debt collection. Accordingly, as the Grant Officer argues, this matter should be remanded to the Grant Officer for appropriate proceedings relating to consideration of the proposed stand-in costs. ***See, e.g., Commissioner, Employment Security of the State of Washington v. U.S. Dept. of Labor,***1990-JTP-29, 1991-JTP-11, 1992-JTP-34 (Sec'y, Sept. 13, 1995) (reversing ALJ's

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[65] I also summarily reject the Grant Officer's argument (Motion p. 46, note 30) that the administrative costs cannot be used as stand-ins because there has been a "closeout" and release by the subrecipients. Any closeout does not, ***inter alia***, affect the right of an agency to disallow costs and recover funds on the basis of a later audit or other review. OMB Circular A-110 __.72. (App. Tab 2). As long as the audit resolution stage remains open, substituted costs may also be considered.

decision and remanding to Grant Officer for consideration of stand-in costs). Alternatively, the parties could agree to develop the issue at the hearing before me.

Finding No. 2

Summary decision on Finding No. 2 is inappropriate as a matter of law and there are factual issues concerning the extent to which the administrative fees paid to the Council out of earned premiums, and credited to membership promotion income, were allocable to the grants as well as the extent to which the administrative costs charged to the grants were devoted to non-grant activities.

There were two paragraphs incorporating Finding No. 2 of the first audit period (quoted above.) The matter addressed in the second paragraph is moot as the Grant Officer has accepted the allocation of administrative fees (based upon 14.5 percent of earned premiums, under Section III of the 1992 Agreement) between Seabury and the Council. In the first paragraph, the Grant Officer questioned $309,825 that the Council received under this arrangement and credited to "membership promotion income." The Grant Officer took the position that, instead, this amount should have been applied as an "offset credit" because it was essentially payment for administrative functions that were directly charged to the grant. The Grant Officer reached the same conclusion with respect to corresponding costs in the amounts of $101,207 and $121,368 for the latter two audit periods, for a total amount of $532,400. (AF-1 at 21 to 23, AF-2 at 19 to 21, AF-3 at 19 to 21).

The Grant Officer is now asserting entitlement to summary decision on this issue. Specifically, the Grant Officer argues that "[t]here is no factual dispute that the grantees received these funds from Monumental under the 1992 Agreement, nor that cost of the very same services had already been directly charged to the grants" and therefore these fees should have been credited to the program under OMB Circular A-122. (Grant Officer's Motion for Partial Summary Disposition at 34).

In response, Complainants state:

> . . . This finding is premised on the undiputed fact that NCSC was paid an administrative fee by Monumental for services performed by office staff in administering the Monumental insurance program while, at the same time, the employees' time was directly charged to the SCSEP grants. . . . In this circumstance, the cited regulation required the Grant Officer to make a determination as to whether the employee hours devoted to the Monumental insurance contract were properly charged to the grant as an allocable and allowable SCSEP grant activity and cost and, if not, to seek reimbursement to the grant for the hours spend on non-grant activities. (Salgado Dep. at 135:17 - 137:14; 139:20 - 141:7). However **the Grant**

> **Officer failed to make the required "grant v. non-grant activity" determination** and, instead, simply claimed the total administrative fees paid by Monumental as "credits" to the SCSEP grant. This "determination," which results in a disallowance which is inflated by at least $236,000, [footnote omitted] ignores the requirements of the cited regulation and the record in this matter and must be set aside as a matter of law.

(Complainant's Response at 25.)

In response, the Grant Officer notes that the amount paid to the Council was 4% of the insurance premiums paid and was not based upon the actual value of the services performed. Thus, the Grant Officer concludes:

> **Since no true allocation of costs could be done, the Grant Officer was not required to credit NCSC and NSCERC with the value of any actual work performed by them.** The administrative fee payments under the 1992 Agreement were not based on a true valuation of the services allegedly performed and, as such, it was proper for the Grant Officer to totally disallow these costs. This arbitrary fee was, in essence, merely **a rebate of premiums** paid by NCSC and NSCERC for the HIP insurance; it was not based on work actually done. The actual value of the work done, and the cost of those services, had already been charged to and paid for by the SCSEP grant. To give NCSC and NSCERC credit against the fees for services performed would be giving them double credit since the grant had already been charged for the work.

(Grant Officer's Reply at 11 to 12).

From the above, the parties essentially agree that the grant was charged for all of the administrative expenses expended by NCSC and NSCERC employees on the Monumental Insurance Program and that NCSC also received 4% of premiums collected (out of the 14.5% payable to NCSC and Seabury) as reimbursement for administrative functions (under section III of the 1992 Agreement, discussed above).[66] Thus, the parties agree that compensation was paid twice for these same services – once, by direct charge to the grant, based upon the cost of actual services performed, and a second time, by a rebate based upon a percentage of collected premiums, not directly related to the actual services performed. The Grant Officer has taken the position that payment received from

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[66] Interestingly, neither party argues that a portion of this amount is for the payment of royalties, even though the earlier version of the agreement included use of the mailing list and logo as part of the "marketing support services" for which Monumental paid NCSC 4 % of earned premiums. (AF-1 at 788)

Monumental for these services should be returned as a credit to the grant program. Complainants argue that instead an allocation of administrative expenses should be made and the amount of costs expended on non-grant activities should be disallowed.

Based upon the cost principles discussed above, I find that the Grant Officer is not entitled to summary decision as a matter of law. While I find that Finding No. 2 is deficient, I do not agree with Complainants that it may simply be set aside at this stage of the proceedings. I find, contrary to Finding No. 2, that both the administrative fees charged to the grant and the credits based upon the Monumental rebates should be adjusted to reflect their grant and non-grant components. Thus, the non-grant component of the fees would be disallowed and the grant component of the rebates would be credited to the grant. In this regard, while it appears that only rebates related to the HIP program – which was devoted primarily (but not exclusively) to senior aides for which the premiums were paid under the grants – have been considered, premium rebates relating to premiums paid by non-grant HIP participants may not be credited to the grant. ***See generally*** OMB Circular A-122, Attachment A, Sec. 5.a. Finding No. 2 is premised upon the unfounded assumption that all of the rebates are allocable to the grant. In addition, it is necessary to determine what portion of the employee time and associated expenses were spent on, or allocable to, the HIP insurance program for senior aides, and what portion was spent on, or allocable to, the Med. Supp. program or the non-grant portion of the HIP program. The costs expended on non-grant activities should be disallowed, as Complainants suggest. ***See generally*** OMB Circular A-122, Attachment A, Sec. 3, 4. Finding No. 2 is premised upon the assumption that there is no need to make such an allocation, because the grant would be credited with the HIP rebates, which exceeded the total administrative costs paid. There are material factual issues relating to the appropriate allocation of both the administrative expenses and the premium rebates. Moreover, the audit reports and final determinations did not disallow administrative costs allocable to non-grant activities, although the matter was raised by Complainants in response to Finding No. 2. Accordingly, the issue may not be properly before me, absent the agreement of the parties. A remand on this issue may be appropriate. However, at this stage of the proceedings, I simply find that summary decision is inappropriate.

As with respect to the premium refunds under section V, I agree with Complainants (Response at p. 29 note 20) that the Research Center should not be held liable during the third audit period for the return of rebates that it never received. However, the disallowance of non-grant administrative costs would also apply to the Research Center and the third audit period.

In view of the above, summary decision on Finding No. 2 is inappropriate as a matter of law. Accordingly, the Grant Officer's motion for summary decision on this issue is denied.

CONCLUSION

In view of the above, partial summary decision is granted in favor of both parties:

(1) First, partial summary decision is granted in favor of the Grant Officer on Finding No. 1. Specifically, I find that the rebates from Monumental to NCSC are appropriately characterized as insurance premium refunds and not as royalties and must therefore be credited to the grants.

(2) Second, partial summary decision is granted in favor of the Complainants on the issue of whether the credits to the grants should be limited to the amounts actually received (or subject to draw down) by Complainants, and I find that they should be so limited.

(3) Third, partial summary decision is granted in favor of Complainants on the issue of the Grant Officer's rejection of the proposed stand-in costs. Specifically, I find that rejection of the proposed stand-in costs on the basis that they were unallowable donations by subrecipients under OMB Circular A-122 was invalid. However, I agree with the Grant Officer that a remand is necessary absent the agreement of the parties because stand-in costs must be considered at the audit resolution phase, where it must still be determined whether the proposed stand-in costs are allowable costs under the grants.

(4) Fourth, partial summary disposition is granted in favor of the Grant Officer on the issue of joint and several liability of NCSC and NSCERC for the first two audit periods. Specifically, I find that NSCERC accepted NCSC's liabilities by virtue of the Novation Agreement. However, I agree with Complainants that NSCERC is not liable for the return of insurance premiums or rebates it never received for the third audit period.

With respect to the remaining issues, I find that summary decision is inappropriate and the motions of both parties on all other issues are denied. Specifically, I find that there is an issue of material fact as to whether the insurance premiums for the HIP program were inherently unreasonable. On the issue of stand-in costs, I find that there is an issue of material fact as to whether the proposed stand-in costs were reimbursable costs. With respect to Finding No. 2, I find that summary decision is inappropriate as a matter of law and that there are issues of material fact.

The parties are being required to consult for the purpose of determining whether a hearing should be immediately scheduled, whether this matter should be remanded, or whether the parties wish to engage in settlement negotiations.

ORDER

IT IS HEREBY ORDERED that the Grant Officer's Motion for Partial Summary Decision is **GRANTED IN PART**, as set forth above;

IT IS FURTHER ORDERED that Complainants' Motion for Partial Summary Decision is **GRANTED IN PART**, as set forth above; and

IT IS FURTHER ORDERED that, within thirty (30) days of the date of this Order, the parties shall meet and jointly or separately advise the undersigned whether the remaining issues are subject to settlement and/or remand, and if not, the parties shall advise of suggested trial dates.

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PAMELA LAKES WOOD
Administrative Law Judge

Washington, D.C.