It's the Law

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Paying Fee or Profit on Grants and Cooperative Agreements

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Introduction

This edition of *It's The Law* addresses the issue of paying a fee or profit on a grant or cooperative agreement ("grant" will be used for both terms throughout this article) awarded by the Department of Commerce. The Department's Grants and Cooperative Agreements Interim Manual (Manual) permits fees or profits to be paid on awards at the discretion of agencies within the Department.[1] As a result of a recent request for a fee by a non-profit organization, the Federal Assistance Law Division (FALD) undertook a detailed analysis of the statutes and cases available on this subject and concluded that the Manual contains provisions that require modification. We concluded that unless there is a specific statute allowing a fee or profit to be paid on a grant, such a payment may not be made regardless of whether the recipient is a commercial or non-profit organization.

The Two-Fold "Purpose" Requirement

A fundamental tenet of grants law is that Congress must pass a statute allowing the award of financial assistance funds.[2] This conclusion comes from specific provisions in the Federal Grant and Cooperative Agreement Act of 1976 (FGCAA).[3] This means that there must

[1] Department of Commerce Grants and Cooperative Agreements Interim Manual, ch. 9, para. D.6. (2002).

[2] "In general, every agency has inherent power to enter into contracts to provide for its needs. However, we cannot assume that agencies have the power to donate Government funds to assist non-Government entities to accomplish their own purposes, however meritorious, without clear evidence that the Congress intended to authorize such an assistance relationship. B-210655 (Apr. 14, 1983). Therefore, in order to provide assistance through a cooperative agreement, there must be some affirmative legislative authorization. Id." 65 Comp. Gen. 605, 607 (1986), *See also* 62 Comp. Gen. 701 (1982) and Dembling and Mason, *Essentials of Grant Law Practice*, §§3.01(a) and 4.02 (1991).

[3] *See* 31 U.S.C. 6301-6308 (Thomson/West, WESTLAW current through P.L. 110-106 approved Oct. 25, 2007). In Sections 6304 and 6305, describing grants and cooperative agreements respectively, the first element listed in determining if an award is

be Congressional authority before an activity being carried out on an award can be funded. Additionally (and completely separate from the FGCAA), the Federal "purpose statute"[4] mandates that appropriated funds awarded by a Federal agency must be used for purposes that Congress has permitted.

In furtherance of both the grant purpose and the appropriations purpose requirements, funds expended by a recipient on a project must be used to carry out the activities of the project as it was authorized: "First and foremost, the expenditure must be reasonably related to the purposes for which the appropriation was made." 63 Comp. Gen. 422, 427 (1984).

A significant recent case in which the Comptroller General (CG) considered how grant funds were expended grew out of the September 11, 2001 terrorist attacks on New York City. It involved a Congressional appropriation to the U.S. Department of Labor for payment to the New York Workers' Compensation Board for processing of claims.[5] The CG determined that payments could not be transferred by that Board to other New York State entities "to cover the cost of workers' compensation benefits paid to or on behalf of state employees injured or killed in the [September 11] attack."[6] As worthy as this other use might be to address the suffering caused by the attacks, it did not meet the purposes of the grant. The CG concluded that unless Congress passed a new law authorizing the transfer, the money had to be returned by New York to the Federal government. In this case, the CG determined that both the grant purpose and the appropriations purpose were not met by the way in which the funds were used.

This case provides the rationale for why fee or profit cannot be paid on grants: they cannot be shown to further the grant or appropriations purposes. For a commercial organization, a profit paid on a grant would presumably be shown on its books as income to the corporation. As income, the corporation could use the money for any corporate reason, including paying dividends to its shareholders. In such a case the grant and appropriations purposes are not being furthered because that use would not be for a cost needed to carry out the project.[7] If the budget item labeled

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financial assistance (grant or cooperative agreement) is when:

> (1) the principal purpose of the relationship is to transfer a thing of value to the State or local government or other recipient to carry out a public purpose of support or stimulation *authorized by a law of the United States* instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government . . . (italics added)

In other words, grants and cooperative agreements must have authorizing statutes.

[4] The purpose statute, codified at 31 U.S.C. 1301(a) (Thomson/West, WESTLAW through P.L. 110-106 approved Oct. 25, 2007), reads as follows: "Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law." That is to say, money can only be spent as the authorizing statutes allow.

[5] *In re* Matter of: Department of Labor-Grant to N.Y. Worker's Comp. Bd., B-303927 (June 7, 2005).

[6] Id. at 6.

[7] The pertinent Federal cost principles issued by OMB dealing with Federal grants are at 2 C.F.R. part 220 (2007), "Cost Principles for Educational Institutions (OMB Circular A-21);" 2 C.F.R. part 225 (2007), "Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87);" 2 C.F.R. part 230(2007) , "Cost Principles for Non-Profit Organizations (OMB Circular A-122);" 45 C.F.R. part 74, app. E (2007), "Principles for Determining Costs

"profit" were used to pay for grant costs instead, then the label can be changed from "profit" to whatever the allowable cost is, thereby meeting the grant and Federal purpose requirements.

For non-profits the "profit" is generally referred to as a "fee" but has the same problem: it is an item above cost, which cannot be in furtherance of the grant activity. Recipients who have received a fee in the past from DOC have identified some of the ways the money has been used: (1) purchase of certificates of deposit to generate income for the organization; (2) purchase of equipment to maintain the quality of the organization's research capabilities; (3) purchase of land for future expansion of the organization's physical plant; and (4) lobbying of Congress for more grant funds. These uses were found not to be in furtherance of the specific grant activities. If the recipient wanted to retain the funds designated on the budget as "profit," it would have to identify an allowable cost not otherwise being claimed and attribute the funds to that.

Authorized Fee or Profit

There is a circumstance in which a fee or profit as discussed above can be paid on a grant: when Congress allows it. In this instance the purpose statute is not violated because of its caveat "except as otherwise provided by law."[8] The one example that has been interpreted by the CG as permitting such a payment is the Small Business Innovation Research (SBIR) Program authorization.[9] The CG interpretation is necessary because the statute itself does not directly address the issue.[10] Congress allowed the Small Business Administration (SBA) to "issue policy directives for the general conduct of the SBIR programs within the Federal Government."[11] In carrying out that authority, the SBA has provided the following in Section 7.(f)(2), of its directive: "(2) **Fee or Profit.** Except as expressly excluded or limited by statute, awarding agencies must provide for a reasonable fee or profit on SBIR funding agreements, consistent with normal profit margins provided to profit-making firms for R/R&D work."[12]

Applicable to Research and Development under Grants and Contracts with Hospitals;" and 48 C.F.R. part 31 (2007), "Contract Cost Principles and Procedures." These documents, which have government-wide applicability, list examples of allowable and unallowable costs and the standards to use when an agency encounters a cost that is not already included in the list. Both the Cost Principles for Universities and Cost Principles for Non-Profits make the following helpful point about what "costs" are not: "Provision for profit or other increment above cost is outside the scope of this part." *See* 2 C.F.R. § 220.10 (2007) and 2 C.F.R. § 230.10 (2007). That is, fee or profit is not a "cost" recognizable on a grant.

[8] We note that there is a statute that authorizes the payment of fees or profits on contracts: 41 U.S.C. 251-266a (Thomson/West, WESTLAW Current through P.L. 110-106 approved Oct. 25, 2007).

[9] The SBIR program, 15 U.S.C. 638, was established in 1982 to assist small businesses in carrying out research and development programs. Federal agencies with research funding are required to allot 2.5% of those funds to an agency-run SBIR competition. Agencies may issue contracts, grants or cooperative agreements can be issued under this program.

[10] "[T]he [SBIR] statute is silent with respect to the specific issue of profits and . . . we are unable to identify any specific congressional intent with respect to this matter . . . ." 71 Comp. Gen. 310, 312 (1992).

[11] 15 U.S.C. 638(j)(1) (Thomson/West, WESTLAW Current through P.L. 110-106 approved Oct. 25, 2007).

[12] 67 Fed. Reg. 60071, 60088 (Sept. 24, 2002).

The Comptroller General concluded that "[p]rofits are authorized by the Administration's policy directive, which, as we discussed above, is a valid exercise of administrative discretion in accordance with the Small Business Innovation Development Act."[13] To reiterate: the CG finds that profits can be paid on SBIR grants because there is a specific statute that allows it. Consistent with this finding, if a recipient requests a fee or profit on a grant, FALD must review it to determine if there is a legal basis for it.

Comptroller General Fee or Profit Case

The case cited in the section above, 71 Comp. Gen. 310, leaves open the possibility that an agency might have the discretion to pay a fee or profit on a grant without a statute authorizing it. In this circumstance, the Department of Health and Human Services (DHHS) requested an exemption from paying fees on its SBIR awards. In the course of concluding that Congress had permitted the SBA the discretion to act as it did to require fees, the CG also commented:

> While some grant programs may not (or do not) contemplate payments of profits, our decisions do not support the Department's [DHHS's] assertion that we have prohibited categorically the payment of a fee or profits on grants. As we observed in 62 Comp. Gen. 701, such an arrangement is permissible if expressly agreed to or otherwise authorized. Here, profits are authorized by the Administration's policy directive, which, as we discussed above, is a valid exercise of administrative discretion in accordance with the Small Business Innovation Development Act.[14]

FALD agrees with the first sentence in this quote, that no case has prohibited payment of a fee or profit on grants to date. FALD does not view the second sentence ("such an arrangement is permissible if expressly agreed to") as dispositive, as that would imply that a fee or profit could be authorized at agency discretion by, say, a term of award. This would raise concerns for the following reasons:

- That statement runs contrary to the holding of the case, which requires a delegation of authority from Congress for an agency to issue regulations implementing a program.[15]

- No other authority is cited for the "permissible if expressly agreed to" language. While the cited case, 62 Comp. Gen. 701, does have such a statement in it,[16] the statement is not the holding of that case, which does not address fee or profit at all, but

[13] *Id.* at 313.

[14] Id. at 313.

[15] "Where, as here, Congress delegates broad authority to an agency to issue regulations implementing a statute, such agency regulations are given controlling weight unless they are arbitrary, capricious or manifestly contrary to the statute." Id. at 312.

[16] "Among the fundamental understandings embodied in a grant agreement which flow from the authorizing statute are that grant funds are to be expended only for the purposes for which they were awarded and are not intended to be used for the profit of the grantee unless expressly agreed to or authorized. *See* 42 Comp. Gen. 289 (1962)." 62 Comp. Gen. 701, 702 (1983).

rather an analogous issue, interest earned on grant funds. Further, the case it cites as authority, 42 Comp. Gen. 289 (1962), does not include the "permissible if expressly agreed to" language in it, does not argue that agencies possess discretion in permitting recipients to retain interest on grant funds, and is not a fee or profit case. In fact, we are aware of no case that has a holding dealing with the general issue of paying fees or profits on grants.

- Concluding that an agency could "expressly agree to" paying a fee or profit in the absence of legislation would completely undermine the CG's reasoning in the "purpose" cases.

Other Authorized Fees?

Are there not situations, though, in which fees are routinely paid on grants? Yes, but they are not of the type addressed in this article. This article is concerned with fees that are *other than* the allowable costs (both direct and indirect) needed to carry out a grant activity. But there are some items called "fees" ("profit" would not be used in this context) that are necessary costs on a grant. Take two examples:

1. A grant recipient needs to hire an architect to design a building on a construction grant. That architect's "fee" is allowable under the cost principles.[17]

2. A recipient organization has established an internal charge-back system to cover the costs of laboratory or machine shop services used by its researchers. The anticipated usage for those internally provided services can be shown on a grant budget submitted to the Federal agency as a "fee" for those services. Those fees can be paid by the grant as necessary for the project.[18]

To restate, these types of fees are not the subject of this article because they are identified costs necessary for the project. In this article, fee or profit deals with money provided to a recipient that is not intended to compensate it for a cost.

Conclusion

As we stated above, since a fee or profit cannot be paid unless there is legislation allowing it, requests for fee or profit by recipients of any type should be referred to FALD for review. Our office can be contacted at (202) 482-1122.

[17] 2 C.F.R. part 220, app. A, § J.37. (2007); 2 C.F.R. part 225, app. B, § 32 (2007); 2 C.F.R. part 230, app. B. para. 37 (2007).

[18] 2 C.F.R. part 220, App. A, § J.47. (2007); 2 C.F.R. 230, app. B. para. 46 (2007).