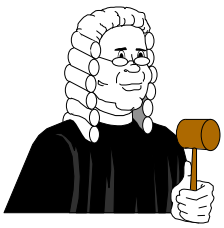

It's The Law

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Say What You Mean

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"Say what you mean and mean what you say." A simple prescription for clarity and understanding, but, as we shall see, often very difficult in application. On September 13, 1995, the Fifth Circuit Court of Appeals, in a two to one decision, reversed a District Court's decision granting summary judgment for the government in the case of *Institute for Technology Development v. Brown*. Although the unique factual circumstances involved should minimize the precedential impact of this decision, it does raise some important issues we need to consider in crafting award language which deviates from the "norms" set forth in applicable OMB Circulars. This article is intended to acquaint you with substance of the Fifth Circuit decision and raise some issues we need to consider regarding the wording of Department of Commerce special award conditions.

BACKGROUND:

Between 1985 and 1988, in response to language in its Appropriations Acts, EDA awarded a series of five grants to the Mississippi Institute for Technology Development ("ITD"). The grants, made under EDA's demonstration project authority (42 U.S.C. § 3151(f)), were to "perform initial Institute staffing, planning and implementation". Each award incorporated relevant OMB Circulars, including A-122. Each award also included a clause providing that the award "can be used only for the research project approved by the Economic Development Administration (EDA) and in conformity with the approved research budget", and, consistent with Congressional intent that the funds be used only to pay for the "start up costs" of ITD, included a clause prohibiting the use of Federal funds "to pay for capital assets or other items not treated as expenses under accepted accounting principles".

In response to an OIG audit, EDA disallowed over one million dollars in costs claimed by ITD. In its appeal, ITD requested that it be allowed to substitute unclaimed depreciation for much of the disallowed costs (a recipient may substitute other allowable costs for costs which have been disallowed, subject to any applicable cost ceiling. *2 United States General Accounting Office Principles of Federal Appropriations Law 10-75* (2d ed. 1992)). In her final audit appeal determination, the Assistant

Secretary for Economic Development denied this request, concluding that the above quoted award clauses supported the conclusion that depreciation was not intended to be an allowable cost under the awards. ITD filed suit, in U.S. District Court for the Southern District of Mississippi, seeking review of this conclusion under the Administrative Procedure Act. Applying the "arbitrary or capricious" standard set forth in 5 U.S.C. § 706(2)(A), and giving deference to the agency's decision, the District Court granted summary judgment for the government. On appeal, in a two to one decision, the Fifth Circuit reversed.

The majority decision in the Fifth Circuit concluded that the issue was a question of law (interpreting the terms of the agreement and OMB Circular A-122, which the Court erroneously described as a **regulation** of a different agency). Consequently, the majority concluded that it owed **no** deference to the agency's determination and it reviewed the matter *de novo*. The majority then decided that since the award was silent on the question of depreciation (apparently concluding that the special award conditions quoted above had no bearing on the issue), A-122 was specifically incorporated into the award, and A-122 recognized depreciation as an allowable cost, the District Court decision was incorrect and the case was remanded to that court where ITD will seek to prove its claims for depreciation.

ISSUES:

It is important to note that the sole issue in this case was the question of whether ITD was entitled to claim depreciation as a substitute cost. Not other issues concerning the audit or disallowed costs were before the Court, nor did the court decide the merits of ITD's claims for depreciation. It also must be stressed that, although the Assistant Secretary determined that depreciation was not intended to be an allowable cost under these awards and cited the above quoted clauses as support for this determination, depreciation was not specifically mentioned anywhere in the award documents other than the above noted reference in A-122. With these points in mind the question is "What should the Department have done to prevail in this case?"

With the benefit of "20-20 hindsight" it is easy to conclude that the Department should have specifically prohibited depreciation as an allowable cost under these awards and specifically noted an exception from the depreciation provisions of paragraph 9 of Attachment B of A-122. Unfortunately, few possess the prescience needed to specifically address such unanticipated issues in award conditions. However, since this decision clearly indicates that courts are willing to substitute their judgment for that of the program officials in the interpretation of award language, it is important that our awards, particularly where we wish to impose terms that differ from the general principles contained in the OMB Circulars, use clear language that is unlikely to be misinterpreted by subsequent tribunals.

Obviously, if program legislation so requires, awards may deviate from the cost principles established in OMB Circulars. The question as to what extent agencies may deviate from the cost principles in other cases, is less clear. The various circulars establishing

cost principles state that they are intended to promote uniformity among agencies and excerptions are discouraged (see *e.g.*, the preamble to A-122, 45 Feg. Reg. 66022 (1980), and paragraphs 1, 3 and 8 of that Circular). On the other hand, paragraph 2.b. of Attachment A speaks of "limitations and exclusions" in the award, and the Uniform Administrative Requirements, 15 CFR § 24.6 (c) and paragraph __.4 of A-110, both allow agencies to make case-by-case exceptions.

The best interpretation of these provisions is that while an agency may not create general exceptions to the cost principles without OMB approval, it may limit the amounts of particular costs it will pay under awards (*e.g.* indirect costs may not exceed 100% of direct), and, in individual awards, create exceptions for sound programmatic reasons. This conclusion is also supported by paragraph 5. *Policy* of new Circular A-87 (60 Fed. Reg. 26489 (1995)) which states:
"This Circular establishes principles and standards to provide a uniform approach for determining costs and promote effective program delivery, efficiency, and better relationships between governmental units and the Federal Government. The principles are for determining allowable costs only. **They are not intended to identify the circumstances or to dictate the extent of Federal and governmental unit participation in the financing of a particular Federal award.**" (Emphasis supplied)

Thus, when we are faced with situations where we want to deviate from the basic cost principles, it is imperative that we carefully examine the language of proposed special award conditions to ensure that they are clear, justified and accomplish the desired objective. In situations such as that faced by EDA in the award to ITD, where we wish to exclude a certain category of cost, armed with the knowledge that substitute costs may raise unanticipated issues (now we know what we meant to say), one possible solution might be to draft a special award condition specifically addressing deviations from the applicable Circular treatment of a specific cost item and/or limiting substitute costs only to budget categories contained in the approved budget submitted by the applicant.
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