

DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: Family Health Care, Inc.
Omaha, Nebraska
Docket No. 78-148
Decision No. 147

DATE: January 29, 1981

DECISION

Grantee, Family Health Care, Inc., appeals from a determination of the Regional Administrator, Region VII, subsequently affirmed by the Public Health Service (PHS) Regional Appeals Board (Docket No. PHS 78-6, decision undated, but transmitted to Grantee by letter dated 11/1/78), disapproving its choice of a marketing consultant to be employed on a grant for a Health Maintenance Organization feasibility study. This Board has jurisdiction in the case under 45 CFR 16.5(a)(3). This decision is based on Grantee's application for review dated 11/10/78 and subsequent submissions to this Board supplementing the application for review, PHS's response to the appeal, and Grantee's response to an Order to Show Cause issued by the Panel Chair. In its response to the Order, Grantee stated that it did not dispute the facts as represented in the Order, although contrary to the Order's summary of the facts, Grantee indicated that it did not request reimbursement of \$1,910.20 expended from its own funds for consulting services. Grantee did not comment specifically on the Order's analysis of the issues. Accordingly, we issue this decision in substantially the same form as the Order, upholding PHS's determination.

The grant was awarded for the period 3/1/78 to 2/28/79 pursuant to Section 1303 of the Public Health Service Act (Pub. L. 93-222, 42 USC 300e-3.) Section 1303 authorizes the Secretary to make grants to public or nonprofit private entities "for projects for surveys or other activities to determine the feasibility of developing and operating or expanding the operation of health maintenance organizations." A health maintenance organization (HMO) is an entity which provides health services to a defined population on a prepaid basis in accordance with certain Federal standards. Grantee, an established health care provider, submitted an application, which was approved, for funding of a study to determine the feasibility of its becoming an HMO.

In accordance with Grantee's approved application, \$5,000 was budgeted for a marketing consultant. The Notice of Grant Award required that all consultants proposed by Grantee be approved by the Regional Office.

The record does not show an explicit request by Grantee for approval of a marketing consultant. Grantee did, however, advise the Regional Office in a letter dated 5/11/78 that it had made the following arrangements for a marketing consultant. Grantee would contract with Dutton & Associates, a CPA firm with which Grantee already did business, which would in turn subcontract the consultant services from Management Design Associates, a management advisory services corporation owned by a number of CPA firms, including Dutton & Associates. Management Design Associates would then select the principal marketing consultant. Other correspondence in the record indicates that the principal marketing consultant was employed by a fourth organization, Medical Administration Resources Center. (Letter from Management Design Associates to Grantee, dated 4/25/78.) Grantee's 5/11/78 letter identified the individuals involved as Mr. Dutton of Dutton & Associates, Mr. Bengston of Management Design Associates, and Mr. Patterson, the principal marketing consultant selected by Mr. Bengston.

The Director, Division of Health Care Systems, in the Regional Office responded to Grantee's 5/11/78 letter by letter dated 6/5/78, which stated that the Region could not approve the proposed consultant arrangement for several reasons, discussed later in this decision. When Grantee requested that this determination be reconsidered, the Regional Administrator by letter dated 8/2/78, stated, with some additional explanation, that the consultant arrangement was not acceptable, and advised Grantee of its right to appeal pursuant to 42 CFR Part 50, Subpart D. Grantee requested review under Subpart D, and following receipt of the decision of the PHS Regional Appeals Board affirming the Regional Administrator's determination, Grantee appealed to this Board.

Grantee's consultant arrangement was disapproved by the Regional Office on a number of grounds. Its first objection was that Mr. Dutton was a member of Grantee's board of directors, and that a contract between an organization and a member of its board of directors was not permissible unless the organization had adopted a conflict of interest policy in its bylaws, which Grantee had not. The second objection was that Dutton & Associates was to function primarily as a go-between in securing consulting services, thus depriving Grantee of the opportunity to develop its own capability for securing such services. The third objection was that Mr. Bengston and Management Design Associates did not have any HMO development experience. The fourth objection was that Mr. Patterson did not have any qualifications as an HMO marketing consultant.

The Regional Office did not cite any established criteria for the employment of consultants as the basis for its disapproval of the marketing consultant. The PHS Regional Appeals Board, however, in affirming the Regional Office's determination, concluded that the Regional Office "acted appropriately and reasonably in applying the criteria for approval contained in Chapter PHS: 1-430." (PHS Regional Appeals Board Decision, p. 2.) The chapter cited by the PHS Board is part of the PHS Grants Administration Manual, which was made applicable to the grant by the Notice of Grant Award. Chapter PHS: 1-430-15B1 requires that grantees obtain prior written PHS approval to contract for the performance of project activities, defined as substantive activities that are central to the purposes of the grant. Chapter PHS: 1-430-20A provides that contracting of activities shall not be approved by PHS unless each of six criteria is met. Those criteria are, as pertinent here, that--

1. The contracting will not reduce the intended role of the grantee in having been selected as the direct recipient of the grant.
2. The contracting is not inconsistent with the intent and purposes of the governing legislation.
3. The contractor, if known, is considered capable of performing the activities.
4. The grantee is considered capable of managing the contracted activities.

Chapter PHS: 1-430-20C further provides, however, that the approval criteria enumerated above "are advisory only and do not limit the right of PHS to disapprove contracting even where the ... criteria are met."

PHS thus clearly had broad discretion in deciding whether to approve Grantee's consultant arrangement. This Board has held that it will not substitute its judgment for that of an agency official where that official's discretion was exercised reasonably and in accordance with the rules explicitly applicable. (Oregon State-wide Cost Allocation Plan, DGAB Docket No. 75-7, Decision No. 22, June 25, 1976; Harrison County Community Action Agency, Inc. DGAB Docket Nos. 75-5 and 76-7, Decision Nos. 35 and 36, March 14, 1977.) The issue in this case is thus whether the Regional Administrator's determination disapproving the consultant arrangement constituted a reasonable exercise of his discretion.

Grantee has advanced a number of arguments regarding the disapproval of its consultant arrangement. In specific response to the grounds for disapproval stated by the Regional Office, Grantee noted first that the Regional Office had not objected on the basis of conflict of interest to its legal consultant, who, like Mr. Dutton, was a member of Grantee's board of directors. (Letter from Grantee to Regional Office dated 6/12/78, p. 1; Letter from Grantee to Director, Division of Grants and Contracts, PHS, dated 8/29/78, p. 2.) The Regional Administrator in his letter to Grantee dated 8/2/78 drew some distinction between the legal consultant and Mr. Dutton with respect to the conflict of interest problem; however, the basis for the distinction is not clear. Even if the Agency failed to enforce the conflict of interest requirement with respect to the legal consultant, however, that would not excuse Grantee's lack of compliance in Mr. Dutton's case, since a conflict of interest policy was clearly required by the terms of the grant. The PHS Grants Policy Statement, revised October 1, 1976, which was made applicable to the grant by the Notice of Grant Award, provides, in a section entitled "Conflict of Interest," that--

Grantees must establish safeguards to prevent employees, consultants, or members of governing bodies from using their positions for purposes that are, or give the appearance of being, motivated by a desire for private gain for themselves or others, such as those with whom they have family, business, or other ties. Therefore, each institution receiving grant support must have written guides for staff members (administrators, faculty members, professional staff, or employees) and other associated individuals (such as consultants) indicating the conditions under which outside activities, relationships, or financial interests are proper or improper, and providing for notification of these kinds of activities, relationships, or financial interests to a responsible and objective institution official. (p. 47.)

In the instant case, there was at least the appearance of impropriety in the awarding of the consultant contract to a firm headed by a member of Grantee's board of directors. A conflict of interest policy, while not necessary to disclose the existence of the relationship, might have provided, for example, that a contract could only be awarded under such circumstances if no other qualified firm were found. In the absence of such a policy, the propriety of the relationship is subject to question.

In response to the Regional Office's objection to the "go-between" function of Dutton & Associates, Grantee noted that it had offered to contract directly with Management Design Associates and that the Regional Office

had not responded to its offer. Grantee nevertheless justified its use of Dutton & Associates on the ground that it was also using the firm for purposes not connected with the grant, and wished to "provide continuity for the overall development of the corporate entity." (Letter from Grantee to Regional Office dated 6/12/78, p. 1; Letter from Grantee to Board's Executive Secretary dated 11/10/78, p. 1.) Despite Grantee's arguments, the Regional Office's objection has substantial merit. As noted previously, one of the criteria for approval by PHS of contracts for the performance of grant activities is that "[t]he grantee is considered capable of managing the contracted activities." Under Grantee's arrangement, it did not have a direct hand in the selection or, apparently, the supervision of the principal marketing consultant. Thus, the Regional Office's disapproval of the arrangement is consistent with this criterion. Even if Grantee had contracted directly with Management Design Associates, the arrangement would be subject to the same objection, since there would still have been an intermediary between Grantee and its principal marketing consultant. It should be noted, moreover, that the Regional Office asserted as the basis for its objection to the "go-between" arrangement that one of the purposes of the grant was to enable an organization to develop its own capabilities in the marketing area. Since the authorizing legislation seems clearly directed at encouraging the proliferation of HMO's, and marketing is apparently central to the formation and continued existence of an HMO, the Regional Office's disapproval is consistent also with the criteria in Chapter PHS: 1-430-20A1 and 2.

As noted previously, the Regional Office also disapproved the marketing consultant arrangement on the ground that the individuals involved did not have specific experience with HMO's. In response, Grantee argued that Mr. Bengston and Mr. Patterson both had related experience, Mr. Bengston as a "management consultant from the financial standpoint," and Mr. Patterson in "marketing activities related to human service organizations," which qualified them as consultants on the grant. (Letter from Grantee to Regional Office dated 6/12/78, p. 2; Letter from Grantee to Director, Division of Grants and Contracts, p. 1.) Grantee also indicated that it did not want a consultant whose primary experience had been with HMO's because such a person would have a "hidden bias" for HMO's and might not consider whether it was in the best interest of Grantee, already an established health care provider, to become an HMO. Grantee argued further that it planned to convert its present practice to a prepayment basis gradually, and thus did not need a precise marketing strategy which could be provided only by persons with a high level of expertise. (Letter from Grantee to Director, Division of Grants and Contracts, dated 8/29/78, pp. 1-3.) Grantee also asserted that it had asked the

Regional Office in March and April of 1978 for advice in choosing a consultant, and proceeded to find its own consultant only when it did not receive any assistance. (Letter from Grantee to Director, Division of Grants and Contracts, dated 8/29/78, p. 1; Letter from Grantee to Board's Executive Secretary dated 11/10/78, p. 1.) Grantee argued finally that it should have been free to make its own mistakes as part of the process of developing its own capabilities, and that it could have chosen another consultant should the initial arrangement have proven unsatisfactory. (Letter from Grantee to Director, Division of Grants and Contracts, dated 8/29/78, p. 2.)

One purpose of the grant condition requiring approval of all consultants would appear to have been to assure that the consultant, if a contractor, was capable of performing the activities, in accordance with Chapter PHS: 1-430-20A3. Although Grantee's consultants might have rendered satisfactory services in this case despite their lack of specific HMO experience, the Regional Office's judgment that they were not qualified is not unreasonable. The fact that Grantee planned to grow slowly as an HMO does not on its face bear any clear relationship to the level of expertise required of a consultant. With respect to Grantee's argument that it should have been free to make its own mistakes, it should be noted that Grantee was in fact relying on a third party to choose its principal consultant, and furthermore, that a purpose of the grant condition requiring approval was to prevent costly mistakes.

Grantee's assertion that it asked the Regional Office for advice in choosing a consultant and received no assistance has not been documented, although Grantee was given the opportunity to do so. We note, in any event, that it is not clear that Grantee would have accepted any advice since it has stated that it did not want a consultant whose primary experience had been with HMO's. Moreover, Grantee has conceded that its own efforts to locate qualified consultants were "minimal." (Letter from Grantee to Regional Office dated 6/12/78, p. 2.) Thus, we find that the Regional Office was justified in disapproving the consultant arrangement on the ground that the consultants were not qualified.

Conclusion

For the reasons set forth above, we conclude that the Regional Administrator's determination disapproving the consultant arrangement constituted a reasonable exercise of his discretion, and we uphold that determination.

/s/ Cecilia Sparks Ford

/s/ Norval D. (John) Settle

/s/ Donald F. Garrett, Panel Chair