

DEPARTMENTAL GRANT APPEALS BOARD

The Department of Health, Education, and Welfare

SUBJECT: Oregon Research Institute, Inc.      DATE: March 9, 1976  
Docket No. 76-2  
Decision No. 34

DECISION

ISSUES

The Oregon Research Institute, Inc. (ORI) appeals the elimination of expenditures for legal services as a basis for the computation of indirect cost rate for the calendar years 1973 and 1974. The expenditures omitted were (1) the \$400 monthly retainer paid to a lawyer (\$4,500 for 1973 and \$4,800 for 1974) and (2) legal fees of \$3,072 (out of a total of \$4,766) paid in 1974, based on hourly charges which the lawyer made in addition to the retainer paid him. The lawyer also served as a member of ORI's Board of Directors and as its controller and secretary-treasurer.

The Regional Director disallowed the retainer payments as not reasonably necessary. He disallowed \$3,072 of the hourly charges for 1974 because they were directly identifiable as relating to negotiations and contracts for the sale of computer software by ORI, an activity not of benefit to grants and contracts.

On September 14, 1976, the Chairman of the Board issued an order to the parties to show cause. That order first described the facts and issues as reflected by the record and directed the parties to show cause by identifying the extent to which the order's statement of facts and issues was incomplete or inaccurate and the reasons, if any, why, on the issue of the legal retainer fee, the appeal should not be, on the one hand, (1) rejected on the ground that the cost of the retainer is an expense which an ordinarily\* prudent person would not have incurred in the conduct of a competitive business where government reimbursement was not anticipated, or, on the other hand, (2) granted at least in part, on the ground that the retainer fee consti-

\*The word "ordinarily" appears in the source document OASC-5

tuted compensation for controller services which could properly have been charged to the grant as compensation for personal services."

It further directed ORI to "show cause in writing why the appeal should not be rejected on the issue of billed legal costs related to computer software sales on the ground that they are specifically identifiable with a particular cost objective and on the ground that its computer software sales were of no benefit to Federal grants and contracts."

The Regional Director responded to the Order to Show Cause in a memorandum dated October 5, 1976. He reaffirmed the prior position he had taken but conceded that the cost of comptroller services "could be compensated at the value of similar services in other organizations."

ORI's response to the order was made by a letter dated October 8, 1976, signed by its attorney as "Secretary-Treasurer." He asserted that the retainer fee did include (but did not assert it was solely for) the cost of his services as controller and secretary-treasurer. He provided documentation to show that the approval action by the Board of Directors was based on an investigation and report made by a committee composed of several of its members. A description of the experiences and qualifications of individual members of the committee and of other members of the Board was submitted and their approval was cited as evidence of the reasonableness of the legal services arrangement.

The response defended the \$40 per hour charge as reasonable in light of the attorney's experience and as equivalent to the charge he makes for office time which he considers to be the "least demanding or lowest class of legal service."

ORI elected not to submit anything further on the elimination of legal services costs which related to sale of computer software, saying that the order accurately reflects ORI's position and its uniform practice.

We find that no material fact is in dispute and that the parties have had full opportunity to present their views and arguments. The matter, therefore, is now ripe for decision.

DISCUSSION

(a) Retainer Payments

The retainer payments should be included as an element of indirect costs only to the extent that they fairly represent reasonable compensation for administrative work as controller, secretary-treasurer or otherwise. We conclude that the Regional Director should allow the reasonable value of such services as have not been paid for by other means, such as through the \$40 per hour charge.

We note the statement in the Regional Director's memorandum of October 5, 1976 that the services "could be compensated at the value of similar services in other organizations." For clarification, we point out that the value of these services should not automatically be limited to what other organizations pay regular employees for performing similar services. Use of an outside professional, who is independent of ORI officials, to perform the administrative duties involved here may make the services more valuable and the determination of that added value will have to involve a subjective judgment which takes into account any special needs of the organization and the experience and other qualifications of the professional. We are not now deciding whether there is a justification for paying more than would normally be paid employees for performing such duties and, if so, how much more. That determination should be made in the first instance by the Regional Director after ORI has had an opportunity to make its position known.

To the extent that the monthly retainer relates to legal services, it should not be considered as part of ORI's indirect costs. The attorney's charges of \$40 per hour for legal services is equivalent to what he charges others for similar services since the services here are basically in the category of "office services."<sup>1/</sup> We can-

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1. There were a few court appearances for which the "minimum bar fee schedule" charge rather than an hourly charge was made.

not accept the argument that the retainer is (1) compensation for time the attorney spends in keeping abreast of legal developments in a highly specialized field, (2) to assure immediate availability of services and (3) for the attorney's loss of employment in conflicting situations.

Addressing the first assertion, there is no indication that the problems are more novel than those encountered in general office practice, particularly in light of the attorney's familiarity with the entire area in which ORI operates as a result of his roles as a member of the Board of Directors, and as controller and secretary-treasurer. Moreover, the substantial volume of hourly legal services rendered in itself assists him in developing a special competence for ORI problems. As to availability of service, there is no showing that ORI has greater need of immediacy than do clients generally. Finally, no facts are given concerning the sacrifice of conflicting employment and we see no reason to assume that these services would produce more conflicts than a general office practice.

Each party submitted surveys of practices of other organizations in paying retainer fees and on costs of legal services to them. We do not give much weight to either survey. The survey submitted by the Regional Director indicates that five other organizations with similar or larger expenditures spend much less on legal services than ORI. This, however, is not shown to be the typical situation but only that of the five surveyed. ORI surveyed organizations, some public and some private, non-profit which it claims shows that some organizations incur greater legal services expenses than it does. It is not possible to ascertain from the data compiled whether these organizations stand in the same position as ORI with respect to their need for legal services or whether the arrangements are comparable.

We believe this decision turns on the criteria for the "ordinarily (sic) prudent person" concept as set out in A Guide for Non-Profit Institutions (OASC-5, Revised August 1974) and quoted in the Chairman's September 14, 1976 Order to Show Cause.<sup>2/</sup> Where a grantee or contractor

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2. The prior issuance of the Guide, dated August 1970, contained an identical provision as does 45 CFR Part 74, appendix F which was published September 19, 1973.

pays the going hourly rate for legal services, it must show unusual compelling reasons for paying in addition a monthly retainer for those services.<sup>3/</sup> As stated above the reasons advanced by ORI here to support the retainer as necessary to obtain legal services are not compelling. Moreover, under the cited provision of the Guide, consideration should be given to the fact that the arms-length relationship is weakened because the attorney also is a member of the Board of Directors and an official of ORI.

ORI also points out that retainer payments were included as allowable indirect costs for prior years without a question having been raised. If so, the inclusion was the result of agency oversight or error. In either case it does not control the action here. Finally, we do not read G31(c) on page 29 of the Guide (OASC-5) that retainer fees to be allowable "must be reasonably supported by evidence of bona fide services available or rendered," as obviating the need for establishing that the basic arrangement itself is reasonable. The Guide does not authorize payment for availability, when payment for that availability is not reasonable.

(b) Hourly Charge as Indirect Costs

Desirably every expenditure would be related to a specific cost objective. This becomes impracticable in the case of some expenditures which have joint cost objectives and for these an allocation by formula is permitted. Guide (OASC-5) section D; 45 CFR Part 74, appendix F, section D.

The expenditures excluded from allocation here were clearly identifiable, and identified, as being for a specific cost objective and they should be so charged. ORI contends that the fact that most of the legal services were for objectives not supported by Federal payments was peculiar to 1974 and that in other years the opposite was true. This

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3. The audit report does not show the total hourly charges for 1973. For 1974 they were \$4,766 at \$40. per hour. Thus if an additional \$4,800 is added for retainer, the hourly cost of legal services would average almost \$80 per hour or twice what is described as the usual rate.

does not place ORI under any disadvantage. It will receive appropriate recognition for any expenditure it makes for a federally assisted objective. Allocation to the objective involved is more precise and realistic than assuming, contrary to known fact, that an expenditure relates to all objectives of the organization.

On the other hand, some of the hourly charges for legal services do relate to multiple cost objectives and have been included as indirect costs.

#### CONCLUSION

The legal retainer payments are not allowable expenditures for legal services but are allowed as administrative costs to the extent that they paid for the performance of the functions of controller and secretary-treasurer or other administration. The agency is directed to make a determination of the amounts involved, subject to ORI's right to further appeal.

The hourly charges of \$3,077 for legal services in 1974 which relate specifically to computer software sales are properly charged to that cost objective rather than as indirect costs.

/s/ Bernice L. Bernstein

/s/ Edward York, Jr

/s/ Edwin Yourman, Panel Chairman