



U.S. House of Representatives Committee on Science, Space, and Technology,
Subcommittees on Oversight and on Research and Technology,
Hearing on “NSF’s Oversight of the NEON Project and Other Major Research Facilities
Developed Under Cooperative Agreements”
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Chairmen, Ranking Members, and Members of the Subcommittees. I’m Kate Manuel, and I am a legislative attorney in the American Law Division of the Congressional Research Service (CRS). I am honored to be testifying before you today on behalf of CRS. This testimony is intended to provide background information regarding (1) when agencies may use cooperative agreements and other types of contractual instruments; (2) the rules governing the allowability of costs under cooperative agreements and other instruments; and (3) the relationship between fees and costs.

Cooperative Agreements and Other Contractual Instruments

Congress enacted the Federal Grant and Cooperative Agreement Act (“Grant Act,” P.L. 95-224) in 1978 in order to provide “uniform statutory guidelines” regarding when agencies may use “procurement contracts,” “grant agreements,” and “cooperative agreements.”¹ Individual examples of each type of instrument could constitute a contract, as that term is generally understood,² and the Grant Act did not alter agencies’ legal authority to enter particular types of instruments.³ Instead, the Grant Act specified

¹ H. REP’T NO. 95-481, 95th Cong., 1st Sess. 2 (1977).

² *See, e.g.*, BLACK’S LAW DICTIONARY 365 (9th ed. 2009) (defining “contract” as “[a]n agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law”); Restatement (Second) of Contracts §1 cmt. a (1979) (“[C]ontract’ [is] ... sometimes used as a synonym for ‘agreement’”); *id.* §3 cmt. a (“[A]greement has in some respects a wider meaning than contract, bargain, or promise. ... The word ‘agreement’ contains no implication that legal consequences are or are not produced.”). In certain cases, individual grant agreements, cooperative agreements, or procurement contracts could be found not to be legally enforceable either because of “defects” in the particular agreement or, particularly in the case of grants, because they are seen to involve “gifts or gratuities.” *See, e.g.*, *Jacqueline R. Sims LLC v. United States*, No. 13-174C, No. 13-196C, Opinion and Order (Fed. Cl., February 25, 2014) (noting that the procurement contracts in question were unenforceable as written because they purported to be requirements contracts, but failed to make the contractor the exclusive provider of services, as is necessary for a requirements contract); *D.R. Smalley & Sons, Inc. v. United States*, 372 F.2d 505, 507 (Ct. Cl.), *cert. denied*, 389 U.S. 835 (1967) (characterizing certain federal grants of highway funds as “gifts or gratuities”).

³ *Cf.* Gov’t Accountability Office, Interpretation of the Federal Grant and Cooperative Agreement Act of 1977, B-196872-O.M. (Mar. 1980) (opining that the Grant Act did not change the types of instruments that an agency could enter, but rather required that agencies use certain instruments in particular circumstances insofar as the agency otherwise had the authority to use that instrument). Authority to enter certain types of instruments is a particular issue with grant and cooperative agreements, since agencies have generally been seen to need express statutory authority to enter such agreements. *See, e.g.*, Gov’t Accountability Office, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, Vol. II, at pg. 10—17 (3d ed. 2006). In contrast, agencies have been seen to have inherent authority to enter procurement contracts. *See, e.g.*, *United States v. Tingey*, 30 U.S. (5 Pet.) 115, 128 (1831).

when agencies may generally use each type of instrument in response to concerns raised by the Commission on Government Procurement⁴ that “[f]ailure to distinguish between procurement and assistance relationships [(i.e., grant and cooperative agreements)] has led to both the inappropriate use of grants to avoid the requirements of the procurement system, and to unnecessary red tape and administrative requirements in grants.”⁵

As amended, the Grant Act currently requires that executive agencies use *cooperative agreements* when the “principal purpose” of the relationship between the agency and a non-federal entity is to “transfer a thing of value” to the non-federal entity “to carry out a public purpose of support or stimulation authorized by a law of the United States,” and “substantial involvement is expected” between the agency and the non-federal entity in carrying out the activity contemplated by the agreement.⁶ *Grant agreements* are akin to cooperative agreements in that their “principal purpose” is also to “transfer a thing of value” to a non-federal entity to carry out an authorized “public purpose of support or stimulation.” However, under the Grant Act, agencies may generally use grant agreements only when “substantial involvement” between the federal agency and non-federal entity is *not* expected (unlike cooperative agreements, where substantial involvement *is* expected).⁷ *Procurement contracts* differ more from grant and cooperative agreements in that they generally do not involve “public purpose[s] of support or stimulation,” but rather the acquiring, “by purchase, lease, or barter,” of “property or services for the direct benefit or use of the United States Government.”⁸ However, the Grant Act also permits agencies to use procurement contracts in other circumstances if the agency “decides in a specific instance that use of a procurement contract is appropriate.”⁹

The distinctions between the three types of instruments addressed by the Grant Act are not necessarily as clear in practice as the language of the act might suggest. Numerous lawsuits have been filed since the Grant Act’s enactment asserting that an executive agency used an improper type of instrument in particular cases—generally a grant or cooperative agreement where, it is claimed, a procurement contract should have been used.¹⁰ Most recently, and perhaps most notably, the Department of Housing and Urban Development (HUD) asked the Supreme Court to review a decision by the U.S. Court of Appeals for the Federal Circuit which found that HUD had purported to have entered cooperative agreements in specific instances when it should have used procurement contracts.¹¹

⁴ Congress established this commission—which was made up of two Members of the House, two Senators, the Comptroller General, two executive branch officials, and five non-governmental members—in 1969 and tasked it with recommending methods to promote the economy, efficiency, and effectiveness of federal procurement. It submitted its findings and recommendations in 1972. See Ralph C. Nash et al., *THE GOVERNMENT CONTRACTS REFERENCE BOOK* 106-107 (3d ed. 2007).

⁵ *Thermalon Indus., Ltd. v. United States*, 34 Fed. Cl. 411, 418 (1995) (quoting S. REP. NO. 449, 95th Con., 2d Sess. 3 (1978)). But see *ICP Northwest, LLC v. United States*, 98 Fed. Cl. 29, 43 (2011) (“specific statutory language” authorizing the use of a particular type of instrument in a way contrary to the Grant Act “should prevail” over the general provisions of the Grant Act).

⁶ 31 U.S.C. §6305.

⁷ 31 U.S.C. §6304.

⁸ 31 U.S.C. §6303(1).

⁹ 31 U.S.C. §6303(2).

¹⁰ See, e.g., *Partidge v. Reich*, 141 F.3d 920, 925 (9th Cir. 1998) (finding that the Office of Federal Contract Compliance Programs correctly determined that certain Federal Emergency Management Agency agreements were grants, not procurement contracts); *360 Training.com, Inc. v. United States*, 104 Fed. Cl. 575, 585 (2012) (finding that the Occupational Safety and Health Administration had purported to use cooperative agreements where it should have used procurement contracts); *Thermalon*, 34 Fed. Cl. at 419 (finding that the National Science Foundation properly denominated the instrument in question as a cooperative agreement); *Anchorage, a Municipal Corp. v. United States*, No. 14-166C, 2015 U.S. Claims LEXIS 17, at *11-*12 (Jan. 22, 2015) (finding the agreement in question a procurement contract, not a cooperative agreement, as the agency claimed).

¹¹ *CMS Contract Mgmt. Servs. v. Mass. Housing Finance Agency*, No. 14-781, Petition for Certiorari (filed S. Ct., Jan. 5, 2015).

No such allegations as to the improper use of cooperative agreements appear to have been raised as to the National Science Foundation's (NSF's) National Ecological Observatory Network (NEON).¹² However, some discussion of procurement contracts would appear to be relevant to discussion of cooperative agreements here because procurement contracts and cooperative agreements are subject to identical or analogous requirements in certain cases.¹³ Indeed, insofar as such requirements are more likely to be litigated in the context of procurement contracts than in the context of cooperative agreements, the case law regarding procurement contracts could help inform understanding of the requirements as to cooperative requirements, provided the fundamental differences in the nature of and authority for these different types of instruments are kept in mind.

Allowability of Costs

“Allowability” is a core concept in compensating the federal government's partners under legal instruments that do not involve the payment of solely fixed amounts or prices, regardless of whether the instrument is a cooperative agreement or procurement contract.¹⁴ Somewhat different factors determine whether particular costs incurred by the government's partner in performing the work are allowable under cooperative agreements and procurement contracts. However, the key factors are generally the same, and serve to limit reimbursable costs to those that are (1) “reasonable,” (2) “allocable,” and (3) conform to any limitations or exclusions set forth in the governing regulations or in the contractual instruments themselves.¹⁵

Costs are deemed to be “reasonable” if, in their nature and amount, they do not exceed that which a “reasonably prudent person” would incur “under the circumstances prevailing at the time the decision was

¹² NSF has express statutory authority, pursuant to 42 U.S.C. §1870(c), to “enter into contracts or other arrangements, or modifications thereof, for the carrying on ... of such scientific or engineering activities as the Foundation deems necessary to carry out the purposes of this chapter ...” See generally *PGMedia, Inc. v. Network Solutions, Inc.*, 51 F. Supp. 2d 389, 403 (S.D.N.Y. 1999); *Thermalon*, 34 Fed. Cl. at 413.

¹³ See, e.g., *infra* **Table 1**.

¹⁴ For example, some procurement contracts—commonly known as cost-reimbursement contracts—provide for the government to reimburse the contractor for all allowable, reasonable, and allocable costs it incurs in performing the contract, up to a total cost specified in the contract. See generally *infra* note 33 and accompanying text.

¹⁵ Compare 2 C.F.R. §200.403 (“Except where otherwise authorized by statute, costs must meet the following general criteria in order to be allowable under Federal awards: (a) [b]e necessary and reasonable for the performance of the Federal award and be allocable thereto under these principles[;] (b) [c]onform to any limitations or exclusions set forth in these principles or in the Federal award as to types or amount of cost items[;] (c) [b]e consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity[;] (d) [b]e accorded consistent treatment ...[;] (e) [b]e determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part[;] (f) [n]ot be included as a cost or used to meet cost sharing or matching requirements of any other federally-financed program in either the current or a prior period ...[;] and] (g) [b]e adequately documented ...”) and Office of Management Circular A-122, Cost Principles for Non-Profit Organizations, revised May 10, 2004, at Attachment A, §A.2.a, available at http://www.whitehouse.gov/omb/circulars_a122_2004/ (“To be allowable under an award, costs must meet the following general criteria: a. [b]e reasonable for the performance of the award and be allocable thereto under these principles[;] b. [c]onform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items[;] c. [b]e consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization[;] d. [b]e accorded consistent treatment[;] e. [b]e determined in accordance with generally accepted accounting principles (GAAP)[;] f. [n]ot be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period[;] and] g. [b]e adequately documented.”) with 48 C.F.R. §31.201-2(a) (“A cost is allowable only when the cost complies with all of the following requirements: (1) [r]easonableness[;] (2) [a]llocability[;] (3) [s]tandards promulgated by the [Cost Accounting Standards] CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances[;] (4) [t]erms of the contract[;] and] (5) [a]ny limitations set forth in this subpart.”).

made to incur the cost,” in the case of cooperative agreements; or “in the conduct of a competitive business,” in the case of procurement contracts.¹⁶

Costs are generally said to be “allocable” if the “goods or services involved are chargeable or assignable to that Federal award or cost objective in accordance with relative benefits received,” in the case of cooperative agreements; or “assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship,” in the case of procurement contracts.¹⁷ This generally means that the costs (1) are “incurred specifically” for the cooperative agreement or procurement contract;¹⁸ (2) benefit both the cooperative agreement/procurement contract and other work of the non-federal entity and can be distributed to them in reasonable proportion to the benefits received;¹⁹ and/or²⁰ (3) are necessary to the overall operation of the non-federal entity.²¹

Costs conform to the limitations or exclusions set forth in relevant federal regulations if they are among those categorized as allowable under the applicable guidelines or regulations. The NSF Office of Inspector General report on NEON specifically discusses allowability under Office of Management and Budget (OMB) Circular A-122,²² which historically set forth the cost principles applicable to non-profit organizations under grant and cooperative agreements. However, the regulations in 2 C.F.R. Part 200 will eventually, if they have not already, supersede those of OMB Circular A-122.²³ Thus, both are noted here. The applicable regulations as to procurement contracts are those in 48 C.F.R. Part 31. Each of these guidelines or regulations define when various costs may be allowable or unallowable, including alcoholic

¹⁶ 2 C.F.R. §200.404 (cooperative agreements), OMB Circular A-122, at Attachment A, §A.3 (same); 48 C.F.R. §31.201-3(a) (procurement contracts).

¹⁷ 2 C.F.R. §200.405(a) (cooperative agreements); 48 C.F.R. §31.201-4 (procurement contracts). Here, OMB Circular A-122 lacks a broad statement about the allocability of costs akin to that given in 2 C.F.R. Part 200, although it notes the same three factors, given below, in determining allocability. *See supra* notes 18 to 20 and accompanying text.

¹⁸ Compare 2 C.F.R. §200.405(a)(i) (costs “incurred specifically for the Federal award”) and OMB Circular A-122, at Attachment A, §A.4.a.(1) (costs “incurred specifically for the award”) with 48 C.F.R. §31.201-4(a) (costs “incurred specifically for the contract”).

¹⁹ Compare 2 C.F.R. §200.405(a)(2) (cost “[b]enefits both the Federal award and other work of the non-Federal entity and can be distributed in proportions that may be approximated using reasonable methods”) and OMB Circular A-122, at Attachment A, §A.4.a.(2) (cost “[b]enefits both the award and other work and can be distributed in reasonable proportion to the benefits received”) with 48 C.F.R. §31.201-4(b) (cost “[b]enefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received”).

²⁰ Compare 2 C.F.R. §200.405(a) (using “and” to link the three provisions) and OMB Circular A-122, at Attachment A, §A.4.a (same) with 48 C.F.R. §31.201-4 (using “or” to link the three provisions).

²¹ Compare 2 C.F.R. §200.405(a)(3) (cost “[i]s necessary to the overall operation of the non-Federal entity and is assignable in part to the Federal award in accordance with the principles in this subpart”) and OMB Circular A-122, at Attachment A, §A.4.a(3) (cost “[i]s necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown”) with 48 C.F.R. §31.201-4 (cost “[i]s necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown”).

²² Nat’l Science Foundation, Office of Inspector General, NSF OIG Audit Report No. OIG-15-6-001, Observations that Warrant NSF’s Attention during Audit on National Ecological Observatory Network, Inc., Nov. 24, 2014, at 4. The rules regarding allowability that apply to a particular instrument are generally those that were in effect when the agreement was entered.

²³ See 2 C.F.R. §200.104(f) (“As described in §200.110 Effective/applicability date, this part supersedes the following OMB guidance documents and regulations under Title 2 of the Code of Federal Regulations ... A-122, “Cost Principles for Non-Profit Organizations” (2 CFR part 230).”); 2 C.F.R. §200.110(a) (“The standards set forth in this part which affect administration of Federal awards issued by Federal awarding agencies become effective once implemented by Federal awarding agencies or when any future amendment to this part becomes final. Federal awarding agencies must implement the policies and procedures applicable to Federal awards by promulgating a regulation to be effective by December 26, 2014 unless different provisions are required by statute or approved by OMB ...”).

beverages, entertainment, and lobbying—all of which appear to have been at issue with NEON.²⁴ See **Table 1** below.

Table 1. Allowability of Certain Costs under the Federal Regulations or Other Guidance Generally Governing Cooperative Agreements and Procurement Contracts

Type of Cost	Treatment under OMB Circular A-122	Treatment under 2 C.F.R. Part 200	Treatment under 48 C.F.R. Part 31
Alcoholic beverages	Unallowable (OMB Circular A-122, Attachment B, at §3)	Unallowable (2 C.F.R. §200.423)	Unallowable (48 C.F.R. §31.205-51)
Entertainment	Costs of amusements, diversions, social activities, and any “directly associated costs” are unallowable (OMB Circular A-122, Attachment B, at §14)	Costs of amusements, diversions, social activities, and “any associated costs” are unallowable, except where specific costs that might be considered entertainment have a “programmatic purpose” and are authorized in the approved budget for the award or with prior written approval of the awarding agency (2 C.F.R. §200.438)	Costs of amusements, diversions, social activities, and “any directly associated costs” are unallowable, and costs unallowable under this cost principle are not allowable under any other cost principle (48 C.F.R. §31.205-14)
Lobbying	<p>Certain costs are unallowable, including costs incurred in:</p> <ul style="list-style-type: none"> (1) attempting to influence the outcomes of federal, state, or local elections, referenda, initiatives, or “similar activities;” (2) establishing, administering, contributing to, or paying the expenses of political parties, campaigns, political action committees, or other organizations established to influence election outcomes; (3) attempts to influence (i) the introduction of federal, state, or local legislation, or (ii) the enactment or modification of pending legislation through communication with members or employees of the legislative branch (including efforts to influence state or local officials to engage in similar activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation; (4) attempts to influence (i) the introduction of federal, state, or 	<p>Certain costs are unallowable, including costs incurred in:</p> <ul style="list-style-type: none"> (1) attempting to “improperly influence” an officer or employee of the federal executive branch to give consideration to or act regarding a federal award or regulatory matter; and (2) in the case of nonprofit organizations and institutions of higher education (IHEs), <ul style="list-style-type: none"> (a) attempting to influence the outcomes of federal, state, or local elections, referenda, initiatives, or “similar procedures” through contributions, endorsements, publicity, or similar activities; (b) establishing, administering, contributing to, or paying the expenses of political parties, campaigns, political action committees, or other organizations established to influence election outcomes; (c) attempts to influence: (i) the introduction of federal or state legislation; (ii) the enactment or modification of any pending 	<p>Certain costs are unallowable, including costs incurred in:</p> <ul style="list-style-type: none"> (1) attempting to “improperly influence” an officer or employee of the federal executive branch to give consideration to or act regarding a federal award or regulatory matter; (2) attempting to influence the outcomes of federal, state, or local elections, referenda, initiatives, or “similar procedures” through contributions, endorsements, publicity, or similar activities; (3) establishing, administering, contributing to, or paying the expenses of political parties, campaigns, political action committees, or other organizations established to influence election outcomes; (4) attempts to influence (i) the introduction of federal, state, or local legislation, or (ii) the enactment or modification of pending legislation through communication with members

²⁴ See NSF OIG Audit Report No. OIG-15-6-001, *supra* note 22.

<p>local legislation, or (ii) the enactment or modification of any pending federal, state, or local legislation by preparing, distributing or using publicity or propaganda, or by urging members of the public to contribute to or participate in demonstrations, marches, rallies, fund raising drives, lobbying campaigns or letter writing or telephone campaigns; and</p> <p>(5) legislative liaison activities, including attending legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effects of legislation, when such activities are carried on in support of or knowing preparation for an effort to engage in unallowable activities.</p> <p>However, there are exceptions (e.g., providing technical and factual presentations of information on topics directly related to the performance of an agreement through hearing testimony, statements or letters to the legislative branch in response to documented requests)</p> <p>(OMB Circular A-122, Attachment B, at §25)</p>	<p>legislation through communication with members or employees of the legislative branch (including efforts to influence state or local officials to engage in similar activity); (iii) the enactment or modification of pending legislation by preparing, distributing, or using publicity or propaganda, or by urging the public to contribute to or participate in demonstrations, marches, rallies, fund raising drives, lobbying campaigns or letter writing or telephone campaigns; or (iv) any government official or employee in connection with a decision to sign or veto enrolled legislation; and</p> <p>(d) legislative liaison activities, including attending legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effects of legislation, when such activities are carried on in support of or knowing preparation for an effort to engage in unallowable activities.</p> <p>However, there are exceptions (e.g., providing technical and factual presentations of information on topics directly related to the performance of an agreement through hearing testimony, statements or letters to the legislative branch in response to documented requests)</p> <p>(2 C.F.R. §200.450)</p>	<p>or employees of the legislative branch (including efforts to influence state or local officials to engage in similar activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;</p> <p>(5) attempts to influence (i) the introduction of federal, state, or local legislation, or (ii) the enactment or modification of any pending federal, state, or local legislation by preparing, distributing or using publicity or propaganda, or by urging members of the public to contribute to or participate in demonstrations, marches, rallies, fund raising drives, lobbying campaigns or letter writing or telephone campaigns; and</p> <p>(6) legislative liaison activities, including attending legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effects of legislation, when such activities are carried on in support of or knowing preparation for an effort to engage in unallowable activities.</p> <p>However, there are exceptions (e.g., providing technical and factual presentations of information on topics directly related to the performance of a contract through hearing testimony, statements or letters to the legislative branch in response to documented requests)</p> <p>(48 C.F.R. §31.205-22)</p>
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Source: Congressional Research Service, based on various sources cited in **Table I**.

Note: **Table I** reflects only the restrictions on the allowability of costs associated with lobbying. For more detailed discussions of federal law regarding lobbying, see CRS Report 96-809, *Lobbying Restrictions on Non-Profit Organizations*, by Jack Maskell; CRS Report RL 31126, *Lobbying Congress: An Overview of Legal Provisions and Congressional Ethics Rules*, by Jack Maskell; CRS Report RL 34725, *“Political” Activities of Private Recipients of Federal Grants or Contracts*, by Jack Maskell; and CRS Report R40947, *Lobbying the Executive Branch: Current Practices and Options for Change*, by Jacob R. Straus.

The general principles noted in **Table 1** would suggest that the costs of alcoholic beverages have historically generally been, and currently remain, unallowable under cooperative agreements. Entertainment costs would generally have been unallowable under OMB Circular A-122, but could potentially be allowable under 2 C.F.R. Part 200 insofar as they have a “programmatic purpose” and are authorized in the approved budget for the award, or with the prior written approval of the awarding agency. The allowability of lobbying costs, in turn, would generally depend, under both OMB Circular A-

122 and 2 C.F.R. Part 200, upon the specific actions taken (e.g., attempting to “improperly influence” executive branch officers or employees versus providing a technical presentation of topics directly related to the agreement’s performance to legislative branch personnel in response to a documented request).²⁵

Beyond these general principles, though, it should also be noted that the terms of the cooperative agreement could also provide for—or potentially purport to remove—certain constraints or limitations on allowability provided for in the regulations. As previously noted, one of the key factors in the allowability of costs is that the costs conform to “any limitations or exclusions set forth in [the regulatory] principles or in the Federal award as to types or amount of cost items.”²⁶ The possibility of alternate provisions as to allowability in a cooperative agreement is arguably particularly significant here, since the current edition of NSF’s *Proposal and Award Policies and Procedures Guide* notes that

[i]n the case of a discrepancy between the special provisions of an NSF grant [a term which here includes cooperative agreements] and the standards of the cost principles [in 2 C.F.R. Part 200], the special provisions will govern.²⁷

This *Guide* also encourages awardees who anticipate charging items of “direct cost”²⁸ that might subsequently be disputed to discuss the matter with their Grants and Agreements Officer, and provides that officers who determine that such costs are “appropriate considering the special requirements of a particular NSF sponsored activity” are to document this through an advance agreement or understanding.²⁹ Such agreements may then be incorporated by specific language in the award notice, or by other written correspondence.³⁰ Other provisions of the *Guide*, OMB Circular A-122, and/or 2 C.F.R. Subpart 200 would appear to suggest some limits upon agencies’ ability to depart from the general standards in drafting particular agreements.³¹ However, the interplay between such provisions and the provisions like that in the *Guide* noted above would appear to be somewhat unclear in terms of which provisions control.

²⁵ NSF has also indicated that its proposed management fee policy, to be found in its Large Facilities Manual, treats the cost of alcoholic beverages, “[m]eals for nonbusiness purposes or so extravagant as to constitute entertainment,” and “lobbying as set forth ... at 2 C.F.R. 200.405” as expenses that “do not benefit” NSF and, thus, as generally inappropriate for inclusion in any “management fees.” See Nat’l Science Foundation, Notice and Request for Comments on the National Science Foundation (NSF) Implementation of Proposed NSF Management Fee Policy, 79 Fed. Reg. 78497, 48498 (Dec. 30, 2014).

²⁶ 2 C.F.R. §200.403(b) (emphasis added). OMB Circular A-122 similarly provides that allowability depends, in part, upon “any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.” OMB Circular A-122, Attachment A, at §A.2.b.

²⁷ Nat’l Science Foundation, *Proposal and Award Policies and Procedures Guide, Part II, Award & Administration Guide*, NSF15-1, Dec. 26, 2014, at pg. V-3. Cf. 2 C.F.R. §200.100(c) (“Cost Principles of this part establishes principles for determining the allowable costs incurred by non-Federal entities under Federal awards. The principles are for the purpose of cost determination and are not intended to identify the circumstances or dictate the extent of Federal government participation in the financing of a particular program or project. The principles are designed to provide that Federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by statute.”).

²⁸ *Direct costs* are “costs that can be identified specifically with a particular final cost objective.” OMB Circular A-122, Attachment A, at §B.1.

²⁹ *Proposal and Award Policies and Procedures Guide*, *supra* note 27, at pg. V-3. Cf. 2 C.F.R. §200.407(k) (noting that prior written approval of the awarding agency is required for entertainment costs).

³⁰ *Proposal and Award Policies and Procedures Guide*, *supra* note 27, at pg. V-3.

³¹ See, e.g., *Proposal and Award Policies and Procedures Guide*, *supra* note 27, at V-2 (“The funding items identified in the NSF award budget constitutes NSF’s authorization for the grantee [or awardee under a cooperative agreement] to incur these costs, provided there is not a specific limitation in the grant language and the costs are otherwise allowable, allocable, and reasonable in accordance with the cost principles contained in 2 CFR § 200, Subpart E.”).

Key Differences between Costs and Fees

“Fees” are potentially distinguishable from costs. Fees are arguably best known in the context of federal procurement contracts, since the Federal Acquisition Regulation (FAR) expressly authorizes the payment of fees—as an allowance for profit—to contractors working under cost-reimbursement contracts,³² as **Table 2** illustrates. (A *cost-reimbursement contract* is one that provides for the government to pay the contractor all allowable, reasonable, and allocable costs of performing specified work, up to a total cost provided for in the contract. A *fixed-price contract*, in contrast, provides for the government to pay the contractor a price whose amount or whose composition is specified at the time the contract is formed.³³)

Table 2: FAR Provisions Regarding Fees Under Cost-Type Contracts

Type of Fees	Use Under FAR
Fixed fees	Cost-plus-fixed-fee contracts provide for payment to the contractor of a negotiated fee that is fixed at the inception of the contract. The fee does not vary with actual cost, although it may be adjusted as a result of the work performed under the contract. The FAR recognizes cost-plus-fixed-fee contracts as “suitable for use” when (1) the circumstances do not allow the agency to define its requirements sufficiently for a fixed-price type contract, or uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract; and (2) the contract is for the performance of research or preliminary exploration or study and the level of effort required is unknown, or the contract is for development and test and using a cost-plus-incentive fee, discussed below, is not practical. Cost-plus-fixed-fee contracts may not be used unless the contracting officer determines that (1) the amount of the price or fee does not exceed the limitations prescribed in 10 U.S.C. §2306(d) (procurements of defense agencies) or 41 U.S.C. §3905 (procurements of civilian agencies); (2) the various factors prescribed in FAR §16.104 regarding the selection of contract type have been considered; (3) a written acquisition plan has been approved and signed at least one level above the contracting officer; (4) the contractor’s accounting system is adequate for determining costs applicable to the contract or order; and (5) adequate government resources are available to award and manage a non-fixed-price contract. (48 C.F.R. §16.306)
Incentive fees	Cost-plus-incentive-fee contracts provide for the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs, with the contract specifying a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula, which provides, within limits, for increases in fees above the target fee under certain circumstances. The increase or decrease in fees under this type of contract is intended to provide an incentive for the contractor to manage the contract effectively. The FAR recognizes this type of contract as “appropriate” for use in acquiring services or in development and test programs when (1) the circumstances do not allow the agency to define its requirements sufficiently for a fixed-price type contract, or uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract; and (2) a target cost and fee formula can be negotiated that are likely to motivate the contractor to manage effectively. (48 C.F.R. §16.405-1)
Award fees	Cost-plus-award-fee contracts provide for a fee consisting of (1) a base amount fixed at the inception of the contract, if applicable and at the discretion of the contracting officer, and (2) an award amount that the contractor may earn, in whole or in part, during performance that is sufficient to provide “motivation for excellence” in the areas of cost, schedule, and technical performance. The FAR contemplates the use of cost-plus-award-fee contracts when (1) the work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, schedule, and technical performance; (2) the likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides the government with the flexibility to evaluate both actual performance and the conditions under which that performance was achieved; and (3) any additional

³² See, e.g., GOVERNMENT CONTRACTS REFERENCE BOOK, *supra* note 4, at 264 (“In government contracting ‘fee’ is the term of art for profit the government agrees to pay on a cost-reimbursement contract. (‘Profit’ is used when the contract is a fixed-price type.)”).

³³ For further discussion of the different types of procurement contracts, see generally CRS Report R41168, *Contract Types: Legal Overview*, by Kate M. Manuel.

administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits of using this type of contract, as documented by a risk and cost benefit analysis to be included in the Determinations and Findings (D&F) required for use with any type of award fee contract. (48 C.F.R. §16.405-2)

Source: Congressional Research Service, based on various sources cited in **Table I**.

Notes: [1] Cost-plus-fixed-fee contracts, cost-plus-incentive-fee contracts, and cost-plus-award-fee contracts are distinct from cost-plus-percentage-of-the-cost contracts, which have been prohibited, as least for purposes of federal procurement law, since the 1950s. See P.L. 81-152, §304(b), 63 Stat. 395 (June 30, 1949) (codified, as amended, at 41 U.S.C. §3905) (procurements of civilian agencies); P.L. 84-508, §2306(a), 70A Stat. 130 (May 9, 1956) (codified, as amended, at 10 U.S.C. §2306(a)) (procurements of defense agencies); 48 C.F.R. §16.102(c). A cost-plus-percentage-of-the cost contract provides for the contractor to be paid a fee whose amount increases based upon the total costs that the contractor incurs.

[2] It should also be noted that the FAR prohibits the use of any type of cost-reimbursement contract, like those noted in **Table I**, when acquiring “commercial items,” or when the contract is awarded using sealed bidding. See 48 C.F.R. §16.301-3(b); 48 C.F.R. §16.201(a). As used here, the term “commercial item” includes “[a]ny item, other than real property, that is of a type customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and (i) [h]as been sold, leased, or licensed to the general public; or (ii) [h]as been offered for sale, lease, or license to the general public” 48 C.F.R. §2.101. It also includes similar services. *Id.* Sealed bidding is one of two main source-selection methods used by the federal government. In *sealed bidding*, the procuring activity awards the contract to the lowest-priced, qualified, responsible bidder without conducting negotiations with the bidders. This is in contrast to the other main source-selection method, *negotiated procurement*, wherein the procuring activity bargains with offerors after receiving proposals, and awards the contract to the offeror whose proposal rates most highly on evaluation criteria that include, but are not limited to, cost or price. In the case of negotiated procurements, any type or combination of types of contracts allowed under Subpart 16 of the FAR may be used. 48 C.F.R. §16.102(b).

The FAR does not specifically address the “management fees” reportedly at issue with NEON. Similarly, there are no provisions in OMB Circular A-122, 2 C.F.R. Part 200, or the NSF’s *Proposal and Award Policies and Procedures Guide* that address either the types of fees recognized by the FAR, or “management fees.”³⁴ However, none of these sources would appear to expressly bar the payment of a fee, in addition to costs, under a cooperative agreement.³⁵ Other agencies appear to have paid “management fees”—as distinct from costs—to non-federal entities performing cooperative agreements in the past.³⁶ Yet other agencies have, however, expressly indicated that they would not provide fees, at least to for-profit entities, under cooperative agreements.³⁷

³⁴ To the contrary, OMB Circular A-122 expressly notes that “[p]rovision for profit or other increment above cost is outside the scope of this Circular.” OMB Circular A-122, at §1.

³⁵ On the other hand, in announcing that it proposed to cease paying “management fees” as profit on grants and cooperative agreements, as noted below, the National Aeronautics and Space Administration (NASA) expressly stated that it has “no express or explicit authority with regard to ‘management fees.’” Nat’l Aeronautics & Space Admin., Profit and Fee Under Federal Financial Assistance Awards: Proposed Rule, 79 Fed. Reg. 10436, 10436 (Feb. 25, 2014).

³⁶ *See, e.g.*, Profit and Fee Under Federal Financial Assistance Awards, 79 Fed. Reg. at 10436 (noting that NASA “is revising the NASA Grant & Cooperative Agreement Handbook to clarify that NASA does not pay profit or fee on Federal Financial Assistance awards, i.e. grants and cooperative agreements, to non-profit organizations.”). NASA further notes that “[t]here appears to have been some confusion with the term ‘management fee,’” and that it would continue to pay “management fees” that are allowable, allocable, reasonable, and necessary costs in accordance with the non-federal entity’s established accounting practices and government cost principles. *Id.* *See also* Nat’l Oceanic & Atmospheric Administration, Financial Assistance for Research and Development Projects in the Gulf of Mexico and Off the U.S. South Atlantic Coastal States; Marine Fisheries Initiative (MARFIN), 63 Fed. Reg. 828 (Jan. 7, 1988) (“Profit or management fees paid to for-profit or commercial organization grantees are allowable at the discretion of NOAA. However, they shall not exceed 7 percent of the total estimated direct costs.”).

³⁷ *See, e.g.*, Office of Juvenile Justice and Delinquency Prevention, Restitution Education, Specialized Training, and Technical Assistance (RESTTA) Program, 49 Fed. Reg. 21572 (May 22, 1984) (noting, among the eligibility requirements for certain funding, that “[f]or-profit organizations must waive any management fee or profit”); U.S. Dep’t of Commerce, Advance Technology Program, 55 Fed. Reg. 12504 (Apr. 4, 1990) (“[F]unds awarded by the Program shall be used only for direct costs and not for indirect costs, profits, or management fees of the funding recipients.”).

The payment of fees to a procurement contractor is generally governed by the terms of the contract regarding the “earning” of these fees, not the allowability of costs. Moreover, once the fees have been paid, the funds are generally seen as indistinguishable from the contractor’s other funds, and may be used in any way that is permissible under generally applicable laws. The same could potentially be said of any fees paid to a non-federal entity under a cooperative agreement, although it should be noted that federal law could sometimes restrict what a recipient of federal funding may do with its own money.³⁸

It is also important to note that the denomination of something as a “fee” or, alternatively, “costs” in a contract is not necessarily dispositive as to which it is. A fundamental principle of contract law is that contracts—including those of the federal government—are construed in light of the parties’ intent.³⁹ In other words, in situations where the contract purports to say one thing, but the parties intended something else, the contract will generally be read in such a way as to be consistent with what the parties intended. Thus, for example, a contract that denominated itself a fixed-price contract could potentially be found to be a cost-reimbursement contract because other provisions of the contract clearly evidence the parties’ intent that the government should reimburse the contractor for certain costs incurred in performing the contract.⁴⁰ A contract that refers to “fees” could potentially be found to involve “costs” for similar reasons. Alternatively, something denominated as “costs” could potentially be found to constitute a “fee.”

Conclusion

In conclusion, cooperative agreements are distinct from procurement contracts in that they are used when the executive agency’s “principal purpose” is “to carry out a public purpose of support or stimulation authorized by a law of the United States,” while procurement contracts are generally used when the agency’s “principal purpose” is to acquire supplies or services “for the direct benefit or use” of the federal government. Nonetheless, the requirements governing agencies’ use of procurement contracts could potentially help illuminate the requirements as to cooperative agreements. Both types of instruments are, for example, subject to similar, although not identical, restrictions upon the allowability of alcohol, entertainment, and lobbying costs. On the other hand, the requirements as to the payment of fees are much more defined as to procurement contracts than they are as to cooperative agreements.

Thank you again for inviting me to appear today. I am happy to respond to your questions.

³⁸ For example, non-profit social welfare organizations that are tax exempt under 26 U.S.C. §501(c)(4) are restricted from engaging in “lobbying activities” if they receive a federal grant, award, or loan. 2 U.S.C. §1611. This prohibition extends to any lobbying activities, including those undertaken with private funds. *See id.*

³⁹ The “plain language” of the agreement is the starting point for interpreting a contract. *See, e.g., McAbee Constr. Co., Inc. v. United States*, 97 F.3d 1431, 1435 (Fed. Cir. 1996). However, the court or other tribunal will not give the words of the agreement their ordinary meaning when it is clear that the “parties mutually intended and agreed to an alternative meaning.” *Harris v. Dep’t of Veterans Affairs*, 142 F.3d 1463, 1467 (Fed. Cir. 1998). It should also be noted that any ambiguities in contracts, including government contracts, are generally construed against their drafter under an interpretative principle sometimes referred to as *contra proferentem*. *See, e.g., HPI/GSA-3C, LLC v. Perry*, 364 F.3d 1327, 1334 (Fed. Cir. 2004). The government is typically viewed as the drafter when it is a party to a contract.

⁴⁰ *See, e.g., LSI Serv. Corp. v. United States*, 422 F.2d 1334 (Ct. Cl. 1970). *See also Jacqueline R. Sims LLC v. United States*, No. 13-174C, No. 13-196C, Opinion and Order (Fed. Cl., February 25, 2014) (finding that a contract that was denominated a “requirements contract” was not of that type, since it did not provide for the vendor to be the exclusive supplier of the government’s needs for goods or services in a particular time or place, as valid requirements contracts must do); *Franklin Co., ASBCA 9750, 65-1 BCA ¶ 4,767, aff’d, Franklin Co. v. United States*, 381 F.2d 416 (Ct. Cl. 1967) (similar).