

DOCUMENT RESUME

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National Science Foundation Claim against University of Colorado under Grant GE-1321 (Biological Sciences Curriculum Study Program). B-186284. June 23, 1977. 48 pp.

Decision by Robert P. Keller, Deputy Comptroller General.

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Organization Concerned: National Science Foundation; University of Colorado.

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The National Science Foundation (NSF) submitted a claim which it asserted against its grantee, the University of Colorado. The claim by NSF for the recovery of "publisher grant" payments was disallowed in its entirety. The claim for publisher payments concerning a text was allowed in full as between NSF and the university. NSF's claim against the university for alleged unauthorized use of NSF "housekeeping" grants was sustained, subject to possible redetermination of the amount. The claim for \$234,769 representing the "profit" from the sale of "single topic films" was disallowed, except for the amount of NSF's Royalty entitlement. The claim for interest earned by the grantee was allowed only to the extent of the interest actually realized from amounts payable to NSF. (Author/SC)

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DECISION



G.G.M.
WRAY
THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20546

FILE: B-186284

DATE: June 23, 1977

MATTER OF: National Science Foundation Claim against University of Colorado under Grant GE-1321 (Biological Sciences Curriculum Study program)

DIGEST:

1. Claim by National Science Foundation (NSF) against its grantee, University of Colorado (University), for recovery of "publisher's grant" payments is disallowed. "Publisher's grant" payments by publishing companies to University represented income attributable to third editions of textbooks, to be produced without NSF financial support. Record does not substantiate NSF's assertion that such payments were de facto royalties, or diversion of royalties, for second edition texts developed under NSF grant. Therefore, payments are not subject to NSF grant clause requirement that income based on sales of grant-supported materials be remitted to NSF.
2. With respect to NSF's claim against University for recovery of \$36,100 in payments by publisher to University for text Biological Science: Patterns and Processes, record indicates that \$36,100 in fact constituted payments based on sales of first edition text which was supported under NSF grant, although publisher's obligation to make first edition royalty payments had terminated. Therefore, such payments must be remitted to NSF in accordance with grant income clause. This is true even though publisher may have claim against NSF for refund.
3. NSF's claim against University for alleged unauthorized use of NSF "housekeeping" grants is sustained, subject to possible redetermination of amount of unauthorized expenditures. University contends that "housekeeping" grants were as available for general administrative support and maintained records of grant expenditures on this basis. However, actual language and background of grant indicates that it was available only for administrative costs attributable to servicing NSF-supported materials.

4. University's misunderstanding of scope of "house-keeping" grants cannot excuse its failure to maintain records capable of specifically identifying expenditures for authorized grant purposes. Thus NSF's calculation of amount of unauthorized expenditures, based on application of formula which has rational basis in theory, is presumptively valid. However, NSF and University may readjust amount of claim based on mutually agreeable method which they believe more accurately reflects amount of unauthorized expenditures.
5. NSF's claim for recovery of "profit" realized by University from sale of "single topic films" developed with NSF grant support is disallowed except for \$1 per film royalty payment to which NSF is concededly entitled. Contrary to NSF's assertions, record demonstrates that NSF agreed to accept \$1 per film royalty in full satisfaction of University's obligation to NSF under grant income clause.
6. NSF is entitled to recover from University interest actually realized by University from temporary investment of funds which are properly remittable to NSF. Of course, NSF cannot recover interest earned on funds concerning which its underlying claims for remittal are disallowed in this opinion.

The National Science Foundation (NSF) has transmitted to our Office, pursuant to 31 U.S.C. § 71 (1970) 1/, a claim which it asserts against the University of Colorado. The claim relates to a grant--"Grant GE-1321"--awarded by NSF to the University in 1963 and amended on many occasions thereafter.

The NSF submission summarizes the background of the grant as follows:

"* * * Grant GE-1321 was awarded to the University of Colorado in January 1963 for support of the 'Biological

1/ This section provides:

"All claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office."

Sciences Curriculum Study (BSCS). A major purpose of the BSCS was to develop a set of model materials for high school biology courses. Three different secondary school textbooks eventually emerged from the work of the BSCS, known as the BSCS 'versions.' The first edition of these textbooks was commercially published in the fall of 1963. BSCS has since revised and updated the three basic BSCS 'versions.' A second edition of these texts was commercially published in 1968, and a third edition in 1973. BSCS has also produced additional materials under NSF Grant GE-1321, including films and other biology texts. -- Recently the BSCS separated completely from the University of Colorado and became incorporated as the Biological Sciences Curriculum Study Company."

The claim results from an audit conducted by NSF which culminated in an audit report issued on August 1, 1974. The purpose of the audit was "to review the income received by BSCS from its activities and to account for its use or its return to the Treasurer of the United States, as provided by the terms of the grant agreements and NSF policies."

The record before us consists essentially of the following materials:

- NSF's letter to us, dated April 6, 1976, transmitting the claim.
- A report by NSF officials captioned "Findings and Conclusions Relating to the August 1, 1974 Report on the Audit of Income Received Under NSF Grant GE-1321." This report (referred to hereafter as the "NSF Follow-up Report") is undated but was apparently prepared shortly after June of 1975. It discusses and analyzes the audit report.
- Two volumes of materials, apparently assembled in connection with the NSF Follow-up Report, which contains the August 1, 1974 audit report itself as well as correspondence and other documents bearing on the claim.
- An October 13, 1976, submission to us by Peter C. Dietze, Esquire, attorney for the BSCS Company, which responds to the NSF submissions described above.
- A letter to us from Mr. Dietze, dated January 25, 1977, enclosing and summarizing statements bearing on the claim which he obtained from former officials of NSF and of certain publishing companies.

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--A letter to us dated June 8, 1977, from the NSF Deputy General Counsel which comments on the January 25, 1977, submission by BSCS.

We note at the outset that, with respect to the interests of the Federal Government, the instant claim is asserted against the University of Colorado as the grantee. At the time the grant was made, BSCS was an organizational unit of the University. While BSCS has since severed its ties with the University and become a separate entity, our concern here is with the accountability of the University to NSF as grantee, rather than with any rights or liabilities between the University and the BSCS Company. However, we also note that the BSCS attorney's October 1976 response to our Office has been specifically endorsed by the University Counsel.^{2/} Accordingly, we are satisfied that the BSCS attorney's response to us also represents the University's position for purposes of contesting the claim.

The claim itself, as presented by NSF, consists of the following five elements:

1. Publishers grants	\$856, 000
2. "Patterns and Processes"	36, 100
3. Unauthorized Administrative Expenses	116, 914
4. Single Topic Films	234, 769
5. Interest (estimated)	23, 714
Total	\$1, 267, 497

Each element of the claim is considered separately hereafter in the order presented by NSF.

I. Publisher's Grants

The first element in NSF's claim consists of \$856, 000 in so-called "publisher's grants" paid by the three "Version" publishers to the University pursuant to provisions in contracts with the publishers for publication of the second editions of the BSCS textbook versions. NSF contends that the publisher's grants constitute, in effect, second edition royalties or payments in lieu of royalties which should be remitted to the Foundation in accordance with the "income" clause of NSF Grant GE-1321. The GE-1321 income clause reads as follows:

^{2/} See letter dated October 11, 1976, to Mr. Dietze from Richard A. Tharp, Esquire, a copy of which was included in Mr. Dietze's submission to us.

"Income derived by the University of Colorado from rents or royalties or from the sale of books, films, or other property rights related to the Biological Sciences Curriculum Study activities shall be placed in a special account or deposited with such agent as may be approved by the Foundation and shall be utilized as determined by the Foundation. Such income shall be remitted to the University to be retained in such special account."

NSF further contends that while it approved the second edition contracts which contained the publisher's grant provisions, such approval resulted from the grantee's failure to fully inform it concerning the nature of these grants.

The University/BSCS responds that the grants were fixed, lump-sum payments not dependent upon second edition sales, and were thus entirely distinct from second edition royalties. They also assert that cognizant NSF officials fully understood the nature of the publisher's grants when the second edition contracts were approved.

In presenting the foregoing contentions and related arguments concerning the publisher's grants, both parties rely upon the extensive factual background developed in the record now before us. The record includes numerous documentary materials which span a period of time commencing in 1963, extending through execution of the second edition contracts in 1968-1969, and covering events which occurred several years thereafter. Accordingly, in order to evaluate the contentions of the parties, it is necessary to recite the background of the publisher's grant matter in some detail.

Part "a," hereafter, outlines what we consider to be the essential facts of the matter. Except as otherwise noted, these facts are not disputed by the parties. Indeed, their divergent positions relate largely to the interpretation of these facts and the conclusions to be drawn from the totality of the circumstances. Part "b" contains our analysis and conclusions on the publisher's grants element of the claim.

a. Factual background

General.

As indicated previously, BSCS developed three different secondary school biology textbooks known as the BSCS "versions." Each was published by a different publisher, as follows: Rand McNally and Company (the "Green Version"), Harcourt Brace and World, Inc. (now Harcourt Brace Jonanovich, Inc.) (the "Yellow Version"), and

Houghton Mifflin Company (the "Blue Version"). These companies are referred to collectively as the "Version publishers." The versions apparently represented the original fruits of BSCS' efforts under the Foundation Grant GE-1321, which was initially designed to fund the development of a set of model materials for high school biology courses.

The first editions of the three BSCS versions had been supported by the NSF grant and were published in the fall of 1963. The first edition publishing contracts between the University and the three version publishers specified a 20 percent royalty rate to be paid by each publisher. However, due to factors not relevant here, the effective royalty rates for the first editions ranged from 13.5 percent to 15.1 percent of net sales receipts. All royalty payments from first edition sales were remitted to NSF in accordance with the "income" clause of Grant GE-1321, quoted supra. There was no arrangement in the first edition contracts for additional payments by the publishers to the University.

As discussed in detail hereafter, second editions of the three versions were also supported by NSF grant funds and were published in 1968-1969. Each second edition contract provided for an 8 percent royalty, to be remitted to NSF, and for an additional lump-sum payment by the publisher to the University which was to be retained by the University for the use of BSCS. These lump-sum payments constitute the "publisher's grants" which are at issue in the first element of NSF's claim. Third editions of the versions were published in 1973. These editions were produced without NSF support and all royalties were retained by the University/BSCS.

Negotiations between BSCS and NSF concerning the second editions.

As early as 1964 the University submitted a proposal to NSF seeking the Foundation's support for revised second editions of the BSCS versions. Initially NSF rejected this proposal. The NSF Follow-up Report states, at pp. 17-18, that this initial refusal--

"* * * was based on the philosophy that NSF should not indefinitely provide support to one group of curriculum developers in any particular subject matter area. Once NSF-supported curriculum materials had served their intended purposes as models, further development and revision by commercial publishers was anticipated."

However, NSF later reconsidered and agreed to support the second editions. While the NSF Follow-up Report attributes this change of heart to "BSCS persistence," there is ample evidence in the record--which is not specifically contested--that NSF's policy was to attain an "orderly transition" for projects such as BSCS from Foundation support to financial

independence. For example, in his statement submitted to the BSCS attorney with reference to the instant claim, Dr. Laurence O. Binder, a former NSF official, 3/ observes:

"In the mid-60's the Foundation was funding numerous curriculum projects * * *. In each case these projects were creatures of the Foundation in that these projects were started with grants from the Foundation and kept active with our support. The future of these projects, some of which, like BSCS, had developed into sizeable institutions, became of great concern to the Foundation. The Foundation could not be responsible for indefinite financial support of these projects. At the same time, a sizeable investment of Federal monies, time and energy had been made which would be jeopardized unless a policy of orderly transition from NSF support to financial independence of these projects was adopted.

"The NSF adopted a policy of enabling the curriculum projects to become financially independent without, however, bringing about termination of NSF support abruptly lest the educational successes and the ability to continue on the part of the grantees be put in jeopardy. The means by which the Foundation assisted its grantees in the problem of transition varied considerably. * * *"

Negotiations between BSCS and NSF concerning the second editions apparently commenced in earnest in 1965 and continued for several years. During this period BSCS was also negotiating with the three version publishers concerning publishing contracts for the second editions. With respect to the negotiations between BSCS and NSF, each party had several basic concerns. One of NSF's principal objectives was to avoid financial support for further BSCS revisions beyond the second editions. It hoped that BSCS and the publishers would assume the full financial burden for such further revisions so that NSF could devote its resources to new curriculum ventures. NSF was also interested in assuring that BSCS and the publishers would arrange for a limited exclusivity for the second editions with royalty-free licensing provided after a period of 4 to 5 years. Finally, NSF was concerned with the royalty rate for the second editions. BSCS' basic position, for purposes here relevant, was that in order for it to become finally independent of the Foundation, it would have to obtain some funds from the publishers for its own use.

3/ Dr. Binder was NSF's "Program Director, Student and Curriculum Improvement Section, Pre-College Education in Science." It is clear from the numerous references to Dr. Binder in the record that he was a key participant in NSF activities concerning the "publisher's grants" and other elements of the claim.

The initial understanding concerning the negotiating procedure for the second edition publishing contracts was that BSCS would negotiate these contracts with the publishers, including both the royalty rate to be remitted to NSF and arrangements for any additional compensation from the publisher to be retained by BSCS. The BSCS officials were uncomfortable with this procedure since it could be viewed as placing them in a conflict of interest situation. Thus Dr. William V. Mayer, the Director of BSCS, stated in a December 27, 1967, letter to the NSF's Dr. Binder:

"* * * I am in the position of negotiating with publishers for the Federal Government. It is obvious that the publishers wish as low a royalty rate as possible. They have some good arguments on their side, including the loss of copyright protection through the free licensing agreement and the fact that we are requesting them to assume the burden of photographic permissions and art costs which, as was communicated to you earlier, have proven excessive. However, I do not wish to be placed in the position of having negotiated, let us say, a five percent royalty for the Federal Government and then subsequently being accused of having made a more generous arrangement with publishers working with the BSCS on the production of additional books or further editions of the current case. I have asked that the National Science Foundation itself set a figure for this negotiation with publishers and with the consummation of that sequence of contracts the BSCS would feel free, without dependence on the rates agreed upon between the Federal Government and the publishers to make other independent negotiations.

"Therefore, I am waiting now for wording of the free license agreement and a royalty figure acceptable to the National Science Foundation before proceeding further."

Presumably in response (at least in part) to this concern, the NSF's Dr. Keith R. Kelson 4/ sent a February 19, 1968 letter to BSCS' Dr. Mayer which established certain "guidelines" for the second edition contract negotiations. These guidelines specified a minimum second edition royalty payment by the publishers for remittal to NSF of at least 15 percent, and required inclusion of a provision terminating the publishers' exclusive licenses to publish the second editions at the end of 1973. (As discussed hereafter, the February 19 letter also established guidelines for treatment of additional payments obtained by BSCS from the publishers.)

4/ Dr. Kelson was associated with NSF's "Education Directorate" during most of the 1960's. From 1968 to 1973 he was Acting Assistant Director of the Education Directorate. His name also recurs throughout the record.

The record clearly indicates that NSF recognized from the outset that a 15 percent minimum second edition royalty was unrealistically high and would not be acceptable to the publishers. The main reasons for this seem to have been (1) that second editions are generally less lucrative than first editions in terms of sales, and (2) that insistence on limited free licensing would further reduce the publishers' profits. Nevertheless, NSF apparently took the position that the publishers should have to assume the burden of justifying a lower royalty rate.

As it turned out, the publishers did balk at the 15 percent minimum and attempted through direct negotiations with NSF to have the rate reduced. Eventually, NSF decided to remove itself from direct royalty negotiations. Thus by letter dated April 5, 1968, the Deputy Director of NSF advised the President of the University of Colorado that BSCS should negotiate the royalty rate and that the Foundation would no longer insist on the minimum 15 percent royalty. This letter also advised that the publishing contracts must be submitted to NSF for review prior to their execution and that the Foundation would need a detailed statement as to the basis on which the proposed royalty rate was determined.

Retention of payments by BSCS.

The most crucial aspect of the various negotiations for purposes here relevant was the arrangements for payments by the publishers to be retained by BSCS. As noted previously, both parties recognized from the outset that BSCS would have to arrange for some payments from the publishers to be retained by it in order to achieve self-sufficiency. Initially BSCS proposed to the Foundation several types of subsidiary arrangements in its contracts with the publishers which would involve formally sharing second edition royalty income between BSCS and the Foundation. However, NSF rejected any direct royalty-splitting arrangement on the basis that it would be inconsistent with the GE-1321 income clause.

BSCS then drafted subsidiary agreements with the publishers under which the second edition royalty rates payable to NSF would be reduced from the first edition rates (stated at 20 percent but with lower effective rates) to 5 percent. In addition, the publishers would pay to the University for the use of BSCS "a sum equivalent to the difference between the current [first edition] royalty rate and that to be supplied the National Science Foundation" under the proposed second edition contracts. However, NSF also rejected this approach as being inconsistent with the income clause.

During the course of the BSCS-NSF negotiations, much was said concerning the meaning and scope of the GE-1321 income clause. NSF emphasized on several occasions, both orally and in correspondence, its construction of the income clause as follows: First, the clause generally prohibited the grantee from retaining any "profits" generated by materials developed with NSF support. Second, any income "derived from or measured by" sales of grant-supported materials would have to be returned

to NSF. On the other hand, BSCS was not precluded from retaining income which was not derived from or measured by such sales proceeds. The scope of the income clause was most specifically described in the February 19, 1968 letter from Dr. Kelson to Dr. Mayer which established second edition contract guidelines:

"All payments by the publishers to BSCS or the University of Colorado, the amount of which is established by reference to income from the sale of the original or revised editions, must be paid to the Foundation. With respect to future revisions, you are free to accept advance royalties or other compensation for services rendered."

It is clear from the record that even before Dr. Kelson's February 19, 1963 letter, BSCS officials recognized that NSF would object to any subsidiary arrangement with the publishers for payments based directly on sales. Thus, for example, in identical December 6, 1967 letters to each of the three Version publishers, Dr. Mayer notified them that the initial draft agreement, whereby BSCS would receive the difference between the second edition royalty rate payable to NSF and the first edition rate, was viewed by the Foundation as an illegal "sub rosa royalty" since "it ties the subsidiary funds for revision and other purposes specifically to sales * * *." Other correspondence initiated by BSCS reflects the same understanding that the payments could not be based directly on sales.

At the same time, BSCS recognized that the subsidiary arrangement would have to be "somehow geared to sales." The solution to this dilemma was, in the view of BSCS, "a lump sum payment extrapolated from sales and not directly related to them to be paid at periodic intervals during the life of the second edition." See, e.g., letter dated December 12, 1967 from Dr. Mayer to Dr. Arnold B. Grobman, Chairman of the BSCS Executive Committee (and former Director of BSCS).

BSCS-publisher negotiations.

Extensive negotiations between BSCS and the Version publishers took place during most of 1968 and 1969. While the record before us recites the history of the negotiations in great detail, it is sufficient here to summarize certain basic features.

First, while some consideration was given to formally styling the subsidiary arrangements for payments to BSCS as advances against third edition royalties rather than grants, a lump sum grant arrangement seems to have been the principal focus of the negotiations and was the mechanism ultimately adopted. BSCS' own negotiation "guidelines" for the second edition contracts, as set forth in an attachment to a letter dated July 15, 1968, from Dr. Grobman to Dr. Mayer, suggested a proposed royalty rate of 6 percent of second edition sales to be remitted in

full to NSF; a "grant" from each publisher in an amount equal to 65 percent of first edition royalties through 1967, to be retained by the University for BSCS; and a 15 percent royalty on the third editions (to be produced without NSF support) which would be retained in full by the University for BSCS.

In essence these guidelines provided the basis for the final contracts for purposes here relevant. The parties ultimately arrived at a royalty for NSF of 8 percent of second edition sales, and subsidiary lump-sum grant payments. The final grant agreement in the Rand McNally contract provided as follows:

"The publishers agree to provide a grant of \$225,000 to the University for use of the BSCS in maintaining the BSCS administrative organization, to provide policy guidance, close contact with the biological community, feedback coordination, and other services indirectly attributable to the costs of preparing the third edition. The said grant shall be payable in ten equal semi-annual installments of \$22,500 each on March 1 and September 1 of each year beginning March 1, 1969."

The grant provisions in the Harcourt Brace and Houghton Mifflin contracts were essentially the same, except for the grant amounts.

It is undisputed that the grant amounts were arrived at by consideration of sales experience, primarily first edition sales. Also, the parties apparently anticipated that the sum of each publisher's second edition royalty payments plus the grant payments would approximate their respective investments of effective royalty rates for the first edition, which ranged between 13.5 percent and 15.1 percent. Thus, while the actual contract provisions are silent in this regard, BSCS officials indicated to each publisher a willingness to reduce third edition royalties if second edition sales fell below expectations. 5/ For example, Dr. Mayer stated in a November 26, 1968, letter to Rand McNally with reference to the grant figure:

5/ In their statements submitted to the BSCS attorney, present or former officials of each version publisher who were involved in the BSCS second edition negotiations deny that there was any separate agreement or understanding concerning a possible reduction in third edition royalties. While there were no formal agreements to this effect, the record clearly indicates that this possibility was at least informally discussed with each publisher.