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U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR
WASHINGTON. D.C.

DATE: December 5, 1994
CASE NO. 92-JTP-17

IN THE MATTER OF

STATE OF FLORIDA, DEPARTMENT OF
LABOR AND EMPLOYMENT SECURITY,

COMPLAINANT,

v.

UNITED STATES DEPARTMENT OF LABOR,

RESPONDENT.

BEFORE: THE SECRETARY OF LABOR

FINAL DECISION AND ORDER

This case arises under the Job Training Partnership Act (JTPA or the Act), 29 U.S.C. §§ 1501-1791 (1988), and the regulations issued thereunder at 20 C.F.R. Parts 626-638 (1993).

BACKGROUND

The Grant Officer issued a Final Determination on March 13, 1993, disallowing $961,003, which the Florida Department of Labor and Employment Security (DLES) accumulated in excess revenues charged to its JTPA program during the Program Years (PY) 1984-1989. Respondent's Exhibit 1: Administrative File (A.F.) at 11-15. The Grant Officer's disallowance was based on an audit report by the U.S. Department of Labor's Office of the Inspector General (OIG), Id. at 46-96, which examined the revenue sources of the State's JTPA Revenue Account, ~-3880 - Job Service

Contract Profit/Loss. [1/] The State used $800,000 of these funds to repay part of a $1.1 million debt resulting from unallowable Comprehensive Employment and Training Act (CETA) program costs previously disallowed by the Grant Officer. The primary objective of the OIG audit was to identify the sources of the contract revenues in the account, the use of the revenues and the State's compliance with cost principles and program regulations in the accumulation of these revenues. A.F. at 58. The auditors found that the use of the G-3880 Account funds violated the terms of the CETA settlement which required the State to repay the debt with non-Federal funds. Id. at 48. The State replenished the funds in the G-3880 Account. Id. at 54.

The OIG also found the accumulation of the funds in the G-3880 Account to be inappropriate and contrary to applicable Federal regulations and cost principles. Id. at 52-53. The account funds were the net accumulated profits realized by excess charges over actual costs by Florida Employment Service Job Service (ESJS) local offices to provide placement services for JTPA participants. The ESJS local offices entered into approximately 250 fixed unit price, performance-based (FUPPB) contracts with another Florida Department of Labor agency, the Division of Labor, Employment and Training (DLET) and various JTPA Service Delivery Area (SDA) subgrantees which were monitored by DLET. DLET is the State Labor Department agency responsible for the administration of JTPA and the Wagner-Peyser Act and

[1/] Detail Summary, A.F. at 68-75.

supervises the ESJS and the Bureau of Job Training. DLET also has oversight of the procurement activity of the SDA subgrantees and local ESJS offices. The OIG determined that the use of FUPPB contracts, as contrasted to cost reimbursement contracts, between units of the same State department was not acceptable, for such contracts could not be considered arm's length transactions. A.F. at 62.

The auditors further determined that the statutory three year time limit to expend program funds had elapsed and recommended that the funds in the G-3880 Account be returned to the U.S. Department of Labor since the funds could not be reprogrammed for JTPA activities. Id. at 63.

The Grant Officer's Initial Determination reflected the OIG's findings with regard to the inappropriateness of the contractual relationship between DLES and the ESJS. The Grant Officer also specifically stated that the State was aware that its use of fixed unit cost contracts containing terms which provided for payment for activities and costs other than the regulatory permissible payment for placement after training did not qualify for the single unit charging provisions of the JTPA regulations at 20 C.F.R. § 629.38(e)(2). [2] Id. at 20.

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[2] 20 C.F.R. § 629.38 entitled [c]lassification of costs provides in part:

(e) . . .

(2) Costs which are billed as a single unit charge do not have to be allocated or prorated among the several cost categories but may be charged entirely to training or retraining services when the agreement:

(i) Is for training under title II or for retraining under (continued...)

The Grant Officer's Final Determination reiterated, with greater detail, that the fixed unit cost contracts entered into by DLET and the SDA's with the ESJS local offices failed to qualify pursuant to the regulations at 20 C.F.R § 629.38(e) (2). Id. at 13.

The State timely appealed the Grant Officer's Final Determination and a hearing was held on July 19, 1993. The presiding Administrative Law Judge (ALJ) issued a Decision and Order (D. and 0.) on May 2, 1994, reversing the Grant Officer's Final Determination. D. and 0. at 10. The Grant Officer excepted to the ALJ's decision and the Secretary accepted the case for review on June 8, 1994.

DISCUSSION

The ALJ determined that the U.S Department of Labor failed to meet its burden of production because it did not put forth enough evidence to establish a prima facie case to support allegations that FDLES violated JTPA regulations. Id. at 5-6. The substance of the ALJ's determination was that the U.S. Department of Labor put into evidence only one contract, that

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[2](...continued)
title III, ...
(ii) Is fixed unit price; and
(iii)(A) Stipulates that full payment for the full unit price will be made only upon completion of training by a participant and placement of the participant into unsubsidized employment in the occupation trained for and at not less than the wage specified in the agreement; ...

(1991)

This regulation does not appear in the current regulations.

being between the Manasota Industry Council, Inc. (Manasota) and DLES, as representative of all 250 FUPPB contracts pertaining to the profits accrued in Account G-3880. The ALJ found that the Manasota contract was in fact violative of the pertinent regulation at 20 C.F.R. § 629.38(e)(2) since the contract contained both fixed unit cost characteristics and cost reimbursement characteristics. He determined, however, that "[w]ithout offering further evidence, USDOL cannot expect to overcome even the relatively weak burden of establishing a prima facie JTPA violation solely on the basis of the Manasota contract." Id. at 6.

The ALJ apparently did not consider the four contracts that FDLES introduced into evidence at the hearing [3/] which he determined were satisfactory to decide the issues involved in the case. ALJ's Order Denying Motion to Admit, issued Nov. 22, 1993, slip op. at 2. FDLES counsel admitted at the hearing that the four contracts were essentially the same as the balance of the 250 contracts and representative of them. [4/] When these

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[3/] Admitted into evidence as Complainant's Exhibits (CX) 32, 33, 34 and 35.

[4/] The colloquy between the ALJ and FDLES Counsel Cummings:

Counsel: I have contracts for you for program years 1986, 1987, 1988, and 1989.

ALJ: So that's five [sic] years?

Counsel : Yes, sir.

ALJ: Okay. How are those contracts different from the remaining contracts? ...

(continued...)

contracts are examined, each contains characteristics of both fixed unit cost contracts and cost reimbursement contracts, and include a payment schedule for the placement of participants without training, [5] all of which is in contravention of specific regulatory requirements. See fn. 2 at 3.

Admittedly, a sample of four contracts, or five in the record if the Manasota contract is also considered, may not be statistically impressive, except for the fact that every contract in the sample fails to meet the regulatory requirements for a single unit charge agreement. This factor in combination with FDLES counsel's assurance regarding the representativeness of the contracts submitted into evidence, and the State's destruction of

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[4] (...continued)

> Counsel : Essentially, Your Honor, I don't feel they're any different. They're all fixed unit price performance based contracts, they all set forth that full payment will be received once placement has been made in the . . . [sic].
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> ALJ : So there's essentially no difference between any of them?
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> Counsel : Basically, Your Honor, I don't think so. They were all written by various service delivery areas. We have 24 service delivery areas throughout the State of Florida, geographically located throughout the state. But those service delivery areas wrote the those contracts pursuant to policy instructions, so far as the specific elements of 629.38(e) (2), those elements are within those contracts.

Transcript (Tr.) at 22-23.

[5] 1. CX 32 at II, 1-3; CX 33 at 5; CX 34 at 6-9, 23; CX 35 at 6,

the pertinent contracts from PY 1983-1985, [6] persuades me to reverse the ALJ's holding that the Grant Officer failed to meet the burden of production.

Since I have determined that the Grant Officer has met the burden of production, the burden of persuasion devolved upon FDLES to show that the balance of the contracts entered into between DLET and the SDA subgrantees with the ESJS local offices met the regulatory requirements governing FUPPB contracts. This they did not do, although the subject contracts, at least for PY 1986-1989 were apparently retrievable by the State. Tr. at 21-22.

The ALJ next determined that the U.S. Department of Labor failed to meet its burden of production with regard to JTPA regulation at 20 C.F.R. § 629.37(a). [7] This regulation requires that all costs be "necessary and reasonable for the proper and efficient administration of the [JTPA] program. ..." Again, the ALJ relies solely upon the U.S Department of Labor's examination of only the Manasota contract, but he neglects the information that was also readily available in JTPA Revenue Account G-3880. A.F. at 68-75. The Detail Summary of the account lists each subgrant by Program Year and JTPA title, and indicates that 160, or 65%, of the contracts produced a high enough level of profits to make up the total losses incurred by the remaining 35% of the contracts and still show an excess net

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[6] ALJ's Order Denying Motion to Admit at 2.

[7] This regulation is at 20 C.F.R. § 627.435 (1993).

profit of almost $1 million. Id. at 62.

This information in the Detail Summary of Account G-3880 should have been available to the DLES JTPA administrators after each Program Year, and a cursory analysis would have revealed that the grants entered into by the DLET and the SDA agencies with the ESJS local offices were excessive in their funding support of the ESJS local offices' JTPA program. The level of profit and the consistent pattern of contracts belies a finding that the State's JTPA administrators were prudently managing the program, incurring only those costs which were necessary. This failure to reduce contracting funding is all the more compelling when one recognizes that DLET was, for all practical purposes, on both sides of the contracting process given their monitoring responsibilities over the contracting entities. I therefore find grounds for reversing the ALJ's finding on this issue as well.

The ALJ likewise faults the Grant Officer's determination that the State violated the provisions of Office and Management and Budget (OMB) Circular A-87, which the State adopted in October, 1983, for its administration of the JTPA program. D. and 0. at 7. The ALJ focuses on a phrase that appears in the Circular that states: "[n]o provision for profit or other increment above cost is intended." The ALJ concluded that since the Circular "merely states that profits are not 'intended' under the JTPA. Stating that the earning of profits is not 'intended' cannot be interpreted to mean that profits are prohibited under the JTPA." Id.

However, it is necessary to read the phrase within the context of the entire section which pertains to the principles governing allowable costs applicable to grants between State entities and the Federal government. The Purpose and Scope section set forth in Attachment A provides:

> 1. Objectives. This attachment sets forth principles for determining the allowable costs incurred by State ... governments under grants ... with the Federal government. . . . The principles are for the purposes of cost determination. ... They are designed to provide that federally-assisted programs bear their fair share of costs recognized under these principles, except where restricted or prohibited by law. No provision for profit or increment above cost is intended. Emphasis provided.

A.F. at 85.

The last sentence modifies the previous sentence, which requires federal funds to pay the federal share of program costs, and that there be no allowance for more than the federal share. The word "intended" is not precatory, but is a form of the noun "intention", denoting a will, design or resolve to do or refrain from doing an act. Therefore, OMB Circular A-87 is applicable to the State's administration of its JTPA contracts and earned profits are not allowable costs.

The ALJ recognizes that the central issue in this case is that the case record contains a factual basis to determine that the State of Florida, through the several divisions of DLES,

operated "a vertical monopoly over the federal JTPA funds with respect to the contracts in question, thereby creating an obvious conflict of interest." D. and 0. at 8. The DLES was, with respect to the contracts with the ESJS, "the federal JTPA fund recipient, the state JTPA administrator, as well as a JTPA service provider." Id.

The ALJ held, however, that because the Grant Officer's Final Determination relied on the State's failure to use arm's length negotiation as a determinant that the costs charged to the JTPA were not reasonable, and that the phrase "arms-length bargaining" as an important consideration in determining grant cost "reasonableness", first appeared in a Federal Register Notice revising OMB Circular A-87 was published subsequent to the audit, that therefore this fundamental aspect of sound business practice was inoperative in the determination of reasonable costs. I disagree. The lack of publication of a specific phrase doesn't negate the principle. The enmeshed relationships between the parties to the ESJS contracts signals a potential conflict of interest. Although the State produced its contracting procedures for the record (CX 36), this production does not rebut a presumption of a potential conflict of interest with the concomitant less than arm's length contract negotiations, given the pattern of significant profits earned by a unit of a State agency contracting with another unit the same State agency. I therefore find that there was a contravention of "sound management practices" and that such excess profits were not

"necessary and reasonable for proper and efficient administration of the grant program", as required by the State's adoption of the earlier issuance of A-87.

I believe it appropriate to comment on the ALJ's discussion regarding the use of fixed unit price, performance based contracts in the JTPA program. There is no question that such contracting mode was permissible during the Program Years in question, nor is there any question that an entrepreneurial service provider would be allowed to make a profit if it was able to satisfy the terms of the contract for less cost than the negotiated amount. This mode of contracting requires, however, that the negotiations be conducted at arm's length. Where, however, the contracting parties are organizationally linked, there has to be of necessity, a punctilious showing that the contracts were rigorously negotiated at arm's length.

The facts in this case are that intra-agency units used fixed cost contracts and the provider entities consistently, if not always, showed a significant profit of charges over costs. The factual burden of persuasion would have to be overwhelmingly convincing that the contracts had been let only after the most stringent negotiations and that the regulatory requirements governing single unit charge contracts were strictly adhered to. That is not the situation in this case. Substantially more than half of the contracts showed net profits that covered the losses of the other contracts, and the State netted almost $1 million. These results belie any claim of rigorous negotiation, written

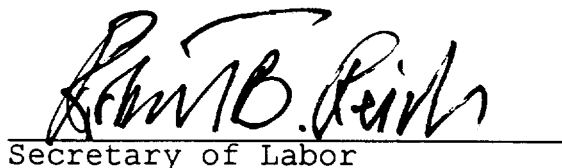
guidelines, notwithstanding.

In addition, the requirements allowing the use of single unit charge contracts found at 20 C.F.R. § 629.38(e) (2) which governed such contracts were not scrupulously followed. The contracts in the record failed to identify specific occupations trained for and their specified wage rates. Instead the contracts provided for gross numbers of participants to be served in a variety of ways to place them eventually into unsubsidized employment. While these are permissible contract goals, they are not within the regulatory requirements utilizing a single unit charge method of contracting.

The DLES used an allowable form of contracting but in an inappropriate situation. The ALJ's decision of May 2, 1994, is REVERSED.

Therefore, I find that the Grant Officer properly disallowed the $961,003 of excess profits accumulated by the State pursuant to the contracts between the DLES and the SDA's with the ESJS local offices. The State of Florida Department of Labor and Employment Security IS ORDERED to pay such amount to the U.S. Department of Labor in non-Federal funds.

SO ORDERED.



Secretary of Labor

Washington, D.C.

CERTIFICATE OF SERVICE

Case Name: Florida Department of Labor and Employment Security v. United States Department of Labor

Case No. : 92-JTP-17

Document : Final Decision and Order

A copy of the above-referenced document was sent to the following persons on DEC - 5 1994.

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