



Can Your Organization Use Federal Grant Funds to Pay Legal Fees?

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The board and senior management of the Community Action Agency (CAA) sat silently contemplating the organization's predicament and its future. The CAA was facing litigation that could determine whether it would continue to exist. Costs to defend the organization would be high but the services of an experienced lawyer were essential. Without one, the CAA might as well consent to a judgment and then prepare to dissolve. However, the CAA had few unrestricted funds to pay for litigation expenses. "What about using federal grant funds to pay agency legal fees?" suggested one member of the board.

The question was simple and straightforward but the CAA would learn that the answer was neither simple nor clear cut. The ability to use federal funds to pay legal fees depends upon how the fees arose. The Office of Management and Budget's (OMB) basic cost guidelines – found in OMB Circular A-122 for private nonprofit grantees (A-122) and OMB Circular A-87 for public programs (A-87)¹ – set rules for the costs that may and may not be charged to federal grants. The rules require that all costs paid with federal funds must be reasonable, allocable to a particular federal program, and documented, among other things.² Additional cost principles then apply to each type of legal fee. Therefore, a grantee must consider whether legal fees arose from: the general administration of federal programs; a private lawsuit; legal proceedings against the government; or a program organization, reorganization, or termination.

Legal Fees Resulting from the Administration of Federal Grants

Grantees routinely incur legal fees that arise from the administration of federal programs, which include, for example, fees associated with conducting real estate closings, arranging development deals, offering tax credits, preparing personnel manuals, and presenting training materials. Federal grant funds may be used to pay these fees if they are reasonable in relation to the services provided and if they are not contingent upon recovery of the costs from the federal government.³ To determine if fees are allowable in a specific case, grantees must consider the legal service provided compared to what was required, the need to contract with an external lawyer,⁴ the past pattern of similar costs, the qualifications and usual fees of the attorney, and the adequacy of the contract (including service description, time required, compensation, and termination provisions). Also, any "retainer" fees must be supported by evidence of services available or rendered.⁵ Moreover, the application of these general principles may be complicated by the application of program-specific rules.

In many circumstances, grantees may use federal grant funds to pay for insurance that covers attorneys' fees in defending lawsuits from third parties.⁶

Litigation Fees

Grantees may also incur legal fees in connection with litigation, and the rules regarding payment of litigation-related legal fees differ depending on whether the litigation involves a private party or a unit of government. In a private lawsuit, the grantee normally may pay the fees with federal grant funds consistent with the general cost allocability and professional fees rules above, with a few exceptions. When Circular A-122 was revised in 1998, OMB comments acknowledged that legal fees from a lawsuit filed by a former employee for termination or by subrecipients are allowable.⁷ However, federal funds cannot cover legal fees incurred in private litigation if the proceeding is an antitrust suit, patent

infringement litigation, or if an organization is found liable or settles when defending a suit brought by an employee under the Major Fraud Act of 1988.⁸ These specific costs are subject to disallowance, and grantees should note that administrative agencies may also disallow legal fees for similar types of litigation.⁹

Government Proceedings

Legal fees incurred in connection with litigation against the government are subject to a different, more restrictive set of rules. In proceedings with the government (which include administrative proceedings, judicial proceedings and investigations), fee allowability largely depends on which side prevails. If the government prevails, the general rule is that legal fees from defenses or claims in administrative or judicial courts are unallowable from the point when an agency issues a final decision letter, such as a disallowance.¹⁰ Should the grantee prevail, the grantee may recover legal fees under the OMB cost guidelines or under the Equal Access to Justice Act.

Under Circular A-122, a private nonprofit that prevails against the government can bill up to 80 percent of legal fees to a federal grant if the fees are reasonable, not prohibited by the sponsored award, not otherwise recovered from the federal government or a third party, and if a federal official determines the percentage to be appropriate.¹¹ OMB comments to the 1998 revision of Circular A-122 indicate that legal fees may be allowable, up to 80 percent, if a nonprofit's position is sustained by the administrative appeal process or a settlement agreement.¹² Prevailing public grantees are not as fortunate; OMB Circular A-87 disallows legal fees whenever a public grantee initiates claims against the government.¹³

In some instances, though, whether the government or the grantee ultimately prevails is not relevant because payment of litigation-related legal fees is covered by program-specific provisions rather than under the general OMB cost principles. For example, the Head Start Act prohibits using Head Start funds to pay legal fees in connection with administrative appeals of terminations, suspensions, and denials of refunding. However, if the grantee prevails, there is a possibility that reimbursement for fees deemed reasonable and may be determined and provided by the Department of Health and Human Services.¹⁴ Since certain programs have specific regulations regarding litigation-related and other legal fees, which may be more or less generous than the ordinary OMB cost principles, grantees must look at program-specific regulations before concluding that a particular litigation related legal fee is or is not allowable.

Equal Access to Justice Act

Nevertheless, a public grantee is not entirely without recourse as either a prevailing private or public grantee can overcome these fee limitations by seeking reimbursement under the Equal Access to Justice Act (EAJA).¹⁵ The EAJA applies to proceedings against the United States before an administrative agency¹⁶ or judicial court¹⁷ regardless of which party initiated the litigation. To be eligible for an EAJA award, a grantee must prevail in a judgment that cannot be appealed. For example, a voluntary change in the government's conduct is not enough to make a grantee a prevailing party,¹⁸ but an order of settlement may be sufficient in a judicial proceeding.¹⁹ To recover fees in an administrative proceeding, the prevailing grantee files an application with the agency showing that they are entitled to receive an award of attorneys' fees pursuant to 5 U.S.C. Section 504 and the amount sought; in a judicial proceeding, the prevailing grantee files an application with the court showing that they are entitled to an award pursuant to 28 U.S.C. Section 2412 and the amount sought. Fees will be awarded unless the agency or court finds that the position of the United States was substantially justified or that special circumstances make the award of attorney's fees unjust.²⁰

Settlement Agreements

Under Circular A-122, a grantee may also be able to charge legal fees from litigation against the government to the grant as part of a settlement or other agreement.²¹ Legal fees arising from a proceeding brought by a state or local government may be charged to a grant when an authorized federal official specifically allows the grantee to use federal funds to pay the fees. A grantee may charge a grant for legal fees arising from a proceeding brought by the federal government when it settles with the government and the settlement agreement states that the fees are allowable costs. However, if a settlement can be interpreted as favorable to the federal government, and the agreement lacks a legal fee

provision, fees may be disallowed. Thus, the terms of the settlement agreement are very important to a grantee hoping to use grant funds to pay for litigation against the federal government.

Reorganization and Grant Termination

Finally, grantees must determine the allowability of legal fees associated with agency or program life-cycle events, which include agency creations or reorganizations and program relinquishments. Regarding the establishment or reorganization of a private nonprofit, OMB Circular A-122 is clear that attorney fees may not be paid with federal grant funds except with prior approval from the awarding agency.²² In the case of program relinquishments, legal costs may be disallowed if the relinquishment is viewed as a termination for default.²³ Again, however, grantees should also look at program-specific laws and regulations for exceptions to these general provisions.

Conclusion

Determining whether legal fees can be paid from federal grant funds can be a difficult task that requires an analysis of the nature of the fees involved and a consideration of general and program-specific cost principles. Proper categorization is important as allowability rules vary greatly depending on the type of legal fee. Ironically, grantees that pay legal fees from grant funds without analyzing the allowability of those fees ultimately may incur more legal fees in defending a decision by the funding source to disallow those costs. Because of the limitations placed on the payment of legal fees from grant funds, grantees should develop reliable sources of unrestricted funds that can be used to pay regularly encountered legal fees that cannot be charged to grant funds.

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¹ The OMB cost principle circulars have been codified in the Code of Federal Regulations (C.F.R.). Circular A-87 (A-87) can be found at 2 C.F.R. Part 225 and Circular A-122 (A-122) can be found at 2 C.F.R. Part 230.

² 2 C.F.R. Part 225, App. A; 2 C.F.R. Part 230 App. A. All references in this article will be to the Code of Federal Regulations Citations.

³ 2 C.F.R. Part 230, App. B, ¶ 37; 2 C.F.R. Part 225, App. B, ¶¶ 10.b and 32.

⁴ See *Marie Detty Youth and Family Services Center*, DAB No. 1643 (1998).

⁵ 2 C.F.R. Part 230, App. B, ¶¶ 37.b-c; 2 C.F.R. Part 225, App. B, ¶¶ 32.b-c.

⁶ 2 C.F.R. Part 230, App. B ¶ 22; 2 C.F.R. Part 225, App. B ¶ 22.

⁷ See *Cost Principles for Non-Profit Organizations*; Notice, 63 Fed. Reg. 29794-5 (June 1, 1998) (1998 A-122 Comments).

⁸ 2 C.F.R. Part 230, App. B, ¶¶ 10.f h.

⁹ See, e.g., *Humanics Associates*, DAB No. 860 (1987) (disallowing legal fees in a suit alleging unfair competition and use of a trade name, on the ground that the suit concerned the livelihood of the organization and protection against competitors rather than the operation of federal programs).

¹⁰ 2 C.F.R. Part 230, App. B, ¶ 10.b; 2 C.F.R. Part 225, App. B, ¶ 10; See 1998 A-122 Comments

¹¹ 2 C.F.R. Part 230, App. B, ¶ 10.e.

¹² See also 1998 A-122 Comments.

¹³ 2 C.F.R. Part 225, App. B, ¶ 10.b.

¹⁴ The 2007 Head Start Reauthorization, "Improving Head Start for School Readiness Act of 2007," Pub. L. 110-134 (2007), required that procedures be established to allow for reimbursement of reasonable and customary fees to be reimbursed in cases where the grantee prevails in an action to terminate or reduce their funding or deny an application for refunding.

¹⁵ See 5 U.S.C. § 504; 28 U.S.C. § 2412.

¹⁶ 5 U.S.C. § 504.

¹⁷ 28 U.S.C. § 2412.

¹⁸ *Buckhannon Bd. and Care Home, Inc. v. W. Va. Dep't of Health and Human Resources*, 532 U.S. 598 (2001).

¹⁹ 28 U.S.C. § 2412.

²⁰ 5 U.S.C. § 504 (a); 28 U.S.C. § 2412 (d).

²¹ 2 C.F.R. Part 230, App. B, ¶¶ 10.c-d.

²² 2 C.F.R. Part 230, App. B, ¶ 31.

²³ 2 C.F.R. Part 230, App. B, ¶ 48.e.