

“Dual Compensation” and “Separate Compensation” Arrangements in the Wake of the Northwestern University Settlement

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ABSTRACT

This commentary makes the case for a re-examination of certain existing guidelines of the Department of Health and Human Services (DHHS) and the National Institutes of Health (NIH) regarding reimbursement of salary costs under NIH grants. The settlement earlier this year involving salary costs and effort reporting at Northwestern University has focused attention on arrangements under which grantee faculty and other personnel receive compensation from two or more legal entities (dual compensation), or from a legal entity other than the grantee (separate compensation). Existing NIH and DHHS guidelines define reimbursable salary narrowly, to include in general only compensation that is paid by the grantee itself. The commentary identifies certain problems that these guidelines cause for some grantees, researchers, and the Government itself, and argues for a more flexible approach that accommodates the many different compensation arrangements that exist today in the field of biomedical research. The commentary concludes that a dual or separate compensation arrangement should be permitted if it (a) results in salary levels that are reasonable and accurately allocated to grants by a workable effort reporting system, and (b) provides a reasonable assurance that the grantee’s performance and compliance obligations will be fully satisfied.

INTRODUCTION

It is becoming increasingly evident, especially in the aftermath of the settlement earlier this year involving compensation and effort reporting at Northwestern University, that some existing policies and practices on charging salaries and wages to grants of the National Institutes of Health (NIH) should be re-examined and adjusted. In particular, the Northwestern case has brought into focus a number of unanswered questions about arrangements under which grantee faculty and other personnel receive compensation from two or more legal entities, or from a legal entity other than the grantee. There is a strong and growing sense in the research community that current government policies and practices do not always deal effectively with the wide variety of such arrangements that exist among NIH grantees. That problem is the subject of this commentary.

The basic difficulty arises from the fact that certain existing NIH and DHHS guidelines define Institutional Base Salary narrowly, for purposes of budgeting and charging NIH grants, to include only compensation that is paid by the grantee itself with a paycheck issued in its own name. For some institutions this narrow definition is entirely appropriate and workable. Many NIH grantees whose personnel receive compensation from two or more sources (e.g., university base salary and clinical practice plan salary) have built effective and fully compliant payroll allocation systems that are designed to account solely for the component of salary paid by the grantee itself. For some of these institutions it would be impractical if not impossible to include other sources of compensation in Institutional Base Salary. In other cases, however, the component of salary paid with a grantee paycheck does not always correspond to a clearly identifiable subset of the employee's effort, and even where it does, limiting Institutional Base Salary to the grantee salary component alone sometimes creates difficulties when personnel shift from one broad category of effort to another (e.g., from clinical to research).

The premise of this commentary is that either approach—including all components of salary in Institutional Base Salary or including only the grantee-paid portion—can in the right circumstances be the basis for a sound, compliant and effective payroll allocation system. Which approach is appropriate for a particular grantee will usually depend on circumstances that government policies and practices do not currently take into account. At present, these policies and practices more or less automatically disfavor the combined compensation approach, often to the detriment not only of grantees and researchers, but also of the Government itself.

Solving this problem will not require revolutionary thinking about payroll allocation, or a major overhaul of how NIH grants are charged for employee compensation. What is needed, rather, is for NIH and its grantees to take a fresh and pragmatic look at a few unresolved salary reimbursement questions and problems that have been lurking under the surface of NIH-sponsored research for some time. It seems clear that the key to any solution is an approach to compensation reimbursement that is flexible enough to accommodate the many different legitimate variations of compensation arrangements that exist today—and will certainly continue to exist in the future. The conclusion to this commentary attempts to sketch out in very broad terms what such an approach might look like.

THE NORTHWESTERN UNIVERSITY SETTLEMENT

In March 2000, an internal “whistleblower” filed a sealed complaint against Northwestern University under the *qui tam* provisions of the federal civil False Claims Act—*United States ex rel. Richard Schwiderski v. Northwestern University et al.* (C.A. No. 02 C 5287, N.D. Ill.). The gravamen of the complaint was that Northwestern had overstated the Institutional Base Salary charged to NIH and other Federal grants by including in the salary of its clinical faculty members not only the compensation paid by the university itself, but also the compensation paid by a separately incorporated clinical practice plan. On its face, the whistleblower's complaint appeared to be a direct challenge to dual compensation arrangements, although as we will see the government's view of the case appears to have been somewhat different. Northwestern ultimately settled the matter with the government and the *qui tam* relator in January of this year, almost three years after the complaint was filed.

The Northwestern settlement has caused many grantees to take a second look at the panoply of different compensation arrangements under which grantee personnel receive compensation from more than one legal entity (referred to in this commentary as “dual compensation” arrangements), or from a legal entity other than the grantee itself (referred to here as “separate compensation” arrangements). Unfortunately,

the resolution of the Northwestern case did not add much clarity to a subject greatly in need of it. It has been very difficult for universities to draw any clear guidance from the Northwestern settlement, and some lessons that are being drawn from it seem incorrect.

As in most such settlements, the parties to the Northwestern settlement expressly agreed to disagree as to what if any basis there might be for the allegations against the university, or what merit there might be to the university's defenses. The government agencies principally involved in the matter—the Department of Justice, the DHHS Office of Inspector General, and NIH—have not yet issued any pronouncements on what principles they think were vindicated by the settlement, or what lessons they think the university community should draw from it. It is unlikely, in fact, that any such pronouncement will ever appear. Because of these circumstances, and because the detailed facts that gave rise to the allegations in the Northwestern case are not publicly known, great care must be taken in ascribing any particular meaning or precedential value to the case.

To my knowledge, the only public government reference to the Northwestern case (other than in the settlement agreement itself) is a summary that appeared in the DHHS Office of Inspector General's semi-annual report for the period ending March 31, 2003. Although quite brief, the summary provides some insight into what the DHHS OIG feels is important about the case:

MISUSE OF PUBLIC HEALTH GRANT FUNDS

In Illinois, Northwestern University (Northwestern) agreed to pay the government \$5.5 million to resolve allegations raised in a False Claims Act *qui tam* complaint about the university's effort reporting under NIH and other extra-mural research grants. The government alleged that in completing applications for the federal grants, Northwestern overstated the percentage of their researchers' work effort devoted to the grant. Northwestern also allegedly knowingly failed to comply with federal requirements that a specified percentage of the researchers' effort be devoted to the grant, and knowingly failed to ensure that total effort, broken down by activity, be reported on the university's effort certification system. The settlement, which stemmed from an OIG audit and investigation, constituted one of the largest settlements with a university for allegations of civil fraud on NIH research grants. (DHHS, OIG, Semiannual Report, p. 36)

Interestingly, this summary makes no explicit reference to the “dual compensation” arrangement that was the centerpiece of the Northwestern whistleblower's complaint. Instead, the summary focuses on three alleged effort-reporting problems—overstatement of actual effort devoted to grants, failure to comply with minimum effort requirements, and failure to account for “total effort” of researchers. There is, to be sure, a close link between what compensation should be included in Institutional Base Salary and what effort a grantee must account for. It is worth emphasizing, however, that the DHHS IG appears to have been concerned primarily if not exclusively with the effort reporting issues themselves. There is no suggestion in the DHHS IG's summary that dual compensation arrangements were considered inherently improper or even problematic.

In fact, the summary strongly implies just the opposite. The allegation in the summary that Northwestern “knowingly failed to ensure that total effort, broken down by activity, be reported on the university's effort certification system” indicates that in the DHHS IG's view university salary allocation systems should be based on total effort. Since salary allocation can be based on total effort only if total compensation is allocated, the implication of the summary is that it is better, in the DHHS IG's view at

least, to include all sources of compensation in Institutional Base Salary—not just the “university” component.

A careful comparison of the complaint and the settlement agreement in the Northwestern case indicates that the other government agencies involved in the case also did not consider dual compensation arrangements to be improper *per se*. As noted above, the central allegation of the whistleblower’s complaint was that salaries earned by clinical faculty members from an independent practice plan were improperly treated as part of the faculty members’ university salaries (*U.S. ex rel. Richard Schwiderski v. Northwestern University*, Complaint ¶¶ 14–21, 29). The settlement agreement, on the other hand, describes the university’s allegedly improper conduct as the inclusion of income from clinical activities compensated by a non-profit foundation “while excluding some or all such clinical activities in calculating the percentage of effort devoted to the grant” (Settlement Agreement II.C(a), emphasis added). The clear implication of the italicized language is that the inclusion of clinical practice income would not have been improper if the university had accounted for clinical activities in its effort reporting system.

This is a critically important point in any attempt to draw “lessons learned” from the Northwestern case. As discussed in this commentary, certain current NIH and DHHS *policies and practices* discourage dual compensation arrangements, but there is nothing in the Northwestern case or any other source of legal authority that suggests that such arrangements are inherently improper. It would be a mistake, therefore, to read the Northwestern case as a legal precedent forbidding or discouraging dual compensation arrangements.

IDENTIFYING THE SOURCE OF THE PROBLEM

The problem addressed in this commentary does not arise because of any fundamental flaw in the cost accounting principles or legal rules that govern the charging of salary costs to federal research. The underlying system of effort reporting and payroll distribution for federal research, as set forth in OMB Circulars A-21 and A-122 and DHHS regulations, remains fundamentally sound and workable. It reflects many years of thinking and negotiation by and between the federal government and the United States research community, and represents in general a sensible balance among sometimes competing considerations. These considerations include, among others: (a) the need for a reasonably accurate allocation of compensation costs to federal research projects, and between organized research and other functions; (b) the practical difficulty of clearly distinguishing research from instruction and other activities in an academic setting; (c) the varying conceptions of full-time effort among, and even within, grantee institutions; and (d) the general reluctance to burden researchers with time-consuming and inflexible effort reporting procedures. Although no one I know is completely happy with the basic compensation reimbursement system created by the OMB Circulars, that situation may be more a mark of a good compromise than of a broken system. On the whole, the system still works as it was intended to.

In the area of biomedical research, however, the OMB Circulars and other basic rules often provide only a starting point. The great variety and complexity of arrangements whereby medical faculty and other biomedical research personnel are paid make it difficult—if not impossible—to come up with simple rules on charging and documenting salaries that make sense in all cases. The principal complication in the biomedical research area, which the OMB circulars and other cost principles really don’t address at all, is the large number of faculty members and other researchers whose salaries are paid or funded by two or more legal entities, or by an entity other than the named NIH grantee.

NIH and DHHS policies have attempted to address this complication, but unfortunately they have done so in a somewhat simplistic and inflexible way. NIH policies generally provide that a grantee may charge NIH grants only for salary costs that the grantee itself incurs—i.e., salary paid by a payroll check issued by the grantee. There are two principal exceptions to this general rule. The first, which appears in the NIH Grants Policy Statement under the heading “Services Provided by Affiliated Organizations,” is that in some circumstances legally separate but closely affiliated organizations (including but not apparently limited to research foundations) may charge for affiliates’ costs as if they were their own costs (NIH Grants Policy Statement, p. 87). The second exception, which as far as I know does not appear in any formal written policy, is that grantees may include salary paid by a separate legal entity (such as a clinical practice plan) in Institutional Base Salary if: (a) the separate compensation is guaranteed by the university; (b) the effort related to the separate compensation (e.g., clinical practice effort) is included on the employee’s appointment form, and the grantee is considered a “common paymaster” with the separate entity; and (c) the effort compensated by both salaries is included and accounted for in the grantee’s effort reporting system. Such arrangements must be specifically approved by DHHS, and to my knowledge only a handful of arrangements have met the criteria and received approval.

As will be discussed, these current government policies and practices with respect to dual or separate compensation arrangements have consequences that are sometimes undesirable from the point of view of the government as well as of many grantees. To take just two important examples, current policies (a) discourage tracking of time and effort on a comprehensive basis by grantees who are otherwise able and willing to do so, and, (b) together with certain other NIH compensation policies, sometimes tend to work against university efforts to increase the participation of clinical faculty in biomedical research. The following sections summarize current government policies in this area, discuss the drawbacks of these policies in the context of certain typical scenarios, and suggest an alternative approach that would better serve the interests of all concerned.

SPECIFIC PROBLEMS THAT ARISE IN APPLYING NIH POLICIES IN DUAL OR SEPARATE COMPENSATION SITUATIONS

The terms “dual compensation” and “separate compensation” do not appear in any pertinent cost principles or policies; they are used in this commentary to identify and distinguish two types of arrangements with somewhat similar implications. A “dual compensation” arrangement is one in which an employee of a grantee receives salary from both the grantee and one or more other legal entities. Typically the other legal entity has some kind of affiliation with the grantee, most often through common or overlapping management or a research affiliation arrangement. A “separate compensation” arrangement is one in which a grantee uses personnel (typically faculty members) on a grant who have appointments at the grantee institution, but whose entire salaries are paid by a separate legal entity (such as a local hospital or research institute). Again, the separate legal entity that pays the researcher’s salary usually has an affiliation of some kind with the grantee, although the nature of such affiliations varies widely.

The variations and permutations on these basic concepts of dual or separate compensation are practically endless. The following examples, though, illustrate the basic situations that appear to arise most frequently:

- **Example A:** A university has created an independently incorporated clinical practice plan, whose membership consists solely of clinical faculty of the university’s medical school. The total salaries of clinical faculty are established by the medical school

department chairs on an integrated basis, taking into account the clinical, research, teaching, and administrative activities of each faculty member. However, the actual payment of each faculty member's salary is made through two paychecks—one from the university and one from the practice plan.

- **Example B:** A university has an arrangement with two local research hospitals, under which researchers in each institution hold joint appointments in the other two. Each researcher is paid by the institution at which he or she spends most of his or her effort, but researchers often spend part of their time working on grants of the other institutions. The institutions compensate each other for this cross-entity effort through a transfer payment arrangement.
- **Example C:** A university has a longstanding relationship with a 501(c)(3) research institute formed and funded by a state government agency. Under this arrangement, the research institute has agreed to fund a portion of the salaries of university faculty members engaged in research. The total salaries of clinical faculty are established by the medical school department chairs on an integrated basis, taking into account the clinical, research, teaching, and administrative activities of each faculty member. Each faculty member receives two paychecks—one from the state research institute and one from the university.
- **Example D:** A university has a research affiliation with a local VA Medical Center, and many university clinical faculty hold part-time or full-time VA appointments and receive both VA and university salaries.
- **Example E:** A research hospital and a research institute, separate legal entities with common management, operate in effect as one entity for research purposes. Researchers are paid either by the hospital or the institute, but not both. Scientists employed and paid by the hospital often work on grants of the institute, and vice versa. Neither entity supports any of the salary of employees of the other entity, either by direct salary payment or by transfer payments to the other entity for time and effort expended on its grants by employees of the other entity.

In basic economic and research policy terms, none of these situations appears inherently problematic or in any way inconsistent with the interests of NIH or other federal sponsors. Depending on how the grantees in question charge for the costs of personnel working on NIH grants, however, existing NIH policies and guidelines may create problems both for the grantees and the government itself. These problems are of several kinds, as discussed below.

Compliant But Less Than Comprehensive Effort Reporting

The instructions to the standard PHS 398 grant application form make it clear that grantees may charge employee salary costs to NIH grants only on the basis of "Institutional Base Salary." "Institutional Base Salary" is defined in the instructions as "The annual compensation *that the applicant organization pays for an employee's appointment*, whether that individual's time is spent on research, teaching, patient care, or other activities" (PHS 398 Instructions, p. 41, emphasis added). NIH has interpreted the phrase "that the applicant organization pays" to mean that a grantee may, in general, not include in Institutional Base

Salary any salary paid to the individual by a separate legal entity, such as a clinical practice plan or an affiliated research institution.

In **Example A** above, therefore, the university would normally be able to include in Institutional Base Salary only the component of the individual's salary that the individual receives in the form of his or her university paycheck. This is where problems begin.

In the example, the total salary received by each faculty member is established on an integrated basis, taking into account each faculty member's clinical, research, teaching, and administrative contributions. It would be this integrated salary, and this salary alone, that would have any real meaning in an economic or market sense. By requiring grantees to include in Institutional Base Salary only the university base salary component that is paid with a university paycheck, NIH requires grantees to focus on a sub-component of salary that may or may not be economically meaningful.

In addition, focusing on a sub-component of compensation may prevent some grantees from tracking effort on a comprehensive basis. It is axiomatic that a grantee's effort reporting system must track the total effort expended by each employee to earn the salary that is used as the basis for charging Federal grants (i.e., in PHS parlance, Institutional Base Salary). Accordingly, if an individual's total compensation (clinical and university base salary) were used as the basis for charging federal grants, the grantee would be required to track the individual's total effort on all activities—both clinical and non-clinical. On the other hand, where the Institutional Base Salary used to charge federal grants is restricted to the amount actually paid by a paycheck from the grantee, the grantee would be required to track only the effort expended by the individual to earn that sub-component of salary. In **Example A**, therefore, the effort that the university would be required to track for payroll distribution purposes would be the individual's non-clinical effort.

An effort reporting system that tracks 100% of the effort expended by each employee to earn his or her Institutional Base Salary is a fully compliant effort reporting system. In fact, any effort reporting system that attempted to track effort that is compensated separately from Institutional Base Salary would be non-compliant for payroll distribution purposes. Other things being equal, however, an effort reporting system that tracks the entirety of an individual's compensated professional effort, rather than just a sub-component of it, is more likely to be understandable to the individual who fills out the effort report, and less likely to result in inconsistencies between or among different sub-components of reported effort.

For example, a university effort reporting system that tracks only non-clinical activity might record a level of sponsored research activity for a faculty member that is consistent with a full-time appointment, while failing to detect that the faculty member also has an exceptionally high level of clinical activity. Although in some cases faculty members may be able to sustain both a full-time non-clinical appointment and a high level of clinical activity, an integrated effort reporting system that tracks all effort is more likely to flag such situations and require confirmation that the high levels of reported clinical and non-clinical effort are not mutually inconsistent.

It should also be observed that a payroll distribution system that tracks effort at the total effort level, rather than at the sub-component level, is likely to be more understandable to the faculty members and other employees who have to fill out effort reports. The question "How do you divide your effort among all compensated professional activities" is simply less confusing than the question "How do you divide your effort among the activities for which you are compensated by the university sub-component of your salary?" (The latter question is particularly difficult to respond to where the university sub-component of

salary is essentially just a funding component, and clearly represents less than full and fair compensation for any identifiable categories of activity.) Other things being equal, less confusion about what the effort reporting form is asking for should lead to better quality effort reporting.

Many NIH grantees whose researchers have two or more sources of compensation would, if they were allowed to include all sources of compensation in Institutional Base Salary, be fully prepared to track total effort on an integrated basis. Encouraging these grantees to move to a total compensation/total effort basis for charging salaries to NIH grants would enhance the comprehensiveness and quality of these grantees' effort reporting systems, to the benefit of the grantees and the government alike. There does not appear to be any strong or even plausible reason for not allowing grantees to move in this direction if they are prepared to do so. Yet at this point, NIH policies definitely discourage many grantees from doing so.

Disincentives to Increasing Research Effort by Clinical Faculty

Current NIH policies on charging salary costs sometimes can, and often do, have significant adverse effects on basic research objectives. A good example, which arises very frequently in actual practice, is the difficulty that dual compensation grantees often have in persuading clinical faculty to engage in more research. It seems illogical and arbitrary that whether clinical faculty members receive one or two paychecks should affect their willingness to do more biomedical research, but the reality is that it frequently does.

Referring again to **Example A**, assume a clinical faculty member receives \$90,000 in clinical salary and \$60,000 in university base salary. He currently works 30 hours a week on university duties (which satisfies his full-time university commitment), and 45 hours a week in clinical practice. He has an opportunity to pursue an NIH grant that would require about 15 hours a week of his time. In order to take advantage of this opportunity, he would have to reduce his clinical effort by 15 hours a week, which would reduce his clinical salary component by one-third, to \$60,000. However, since he is already a full-time faculty member, his additional 15 hours a week of research would in itself normally not, under current NIH policies, permit the university to increase the university component of his salary. (The PHS 398 definition of Institutional Base Salary states that "Base salary may not be increased as a result of replacing institutional salary funds with grant funds" [PHS 398 Instructions, p. 41].) The result would be that by taking on the NIH grant he would suffer an overall reduction in his total salary, from \$150,000 to \$120,000.

If the same clinical faculty member received all of his compensation in a single paycheck from the university, on the other hand, he could readily shift effort from clinical practice to research without affecting his total salary at all. In that case, his Institutional Base Salary would be \$150,000 before and after the shift. He would show 20% effort (15 hours a week out of a total of 75) on his grant proposal, resulting in NIH salary funding of \$30,000, which would replace the economic value of the clinical activity he had given up in order to perform the research. That would be a sensible and positive result, which would be consistent with the objectives of the researcher, the university, and the government.

There is clearly no good reason for allowing technical compensation issues of this sort to create obstacles to greater participation in research by clinical faculty. However, as long as NIH's current policies limit Institutional Base Salary to amounts paid with a grantee paycheck, such obstacles will remain.

Arbitrary Salary Amounts

Example A and **Example C** both involve situations in which the total compensation of employees working on NIH grants—although established on an integrated basis—is actually paid to the employees in two separate paychecks. In situations like these, as noted above, it is often only the total salary, and not its sub-components, that has any real meaning in an economic or market sense. The sub-components of the salary—clinical vs. university base in **Example A**, or university vs. state in **Example C**—may or may not have any economic or market significance in their own right, and often they don't. In the clinical practice plan context, for example, it is not uncommon for the university base component to be set at a relatively low level, which does not in fact represent the “market value” of all of the non-clinical contributions that the faculty member makes. Where two different research institutions are supporting the salaries of researchers, as in **Example C**, the amount of each institution's contribution to a particular salary may depend on availability of funding and other accidental factors, rather than on any conception of services rendered to the funding institution. In these circumstances, it seems arbitrary to require the grantee to include in Institutional Base Salary only the sub-component of a researcher's salary for which it happens to issue a paycheck.

Inconsistencies in How Effort is Presented in Proposal Budgets

Assume that in **Example C** a particular researcher has total compensation of \$160,000, which he receives in two series of biweekly paychecks—one series in the annual amount of \$60,000 from the university and the other in the annual amount of \$100,000 from the state research institute. Assume also that the researcher is applying through the university for an NIH grant, on which he intends to spend 30% of his professional effort—or \$48,000 worth of effort (30% of \$160,000). How should he present this information in his proposal budget?

Under NIH's interpretation of Institutional Base Salary, the researcher's Institutional Base Salary would be limited to \$60,000—the amount paid with a university paycheck. Using that amount as a base, the \$48,000 worth of effort that the researcher intends to devote to the NIH grant equates to 80% effort (\$48,000 divided by \$60,000). Although 80% effort is an accurate reflection of the percentage of university-compensated effort that will be devoted to the grant, it far exceeds the 30% that would be shown in the grant proposal if effort were to be expressed on a total, integrated basis. It seems obvious that the 30% figure is a more useful figure, because it allows NIH to (a) make a better judgment of how much effort will be expended in relation to total available effort; (b) consider the proposed level of effort in relation to other existing and pending research commitments of the researcher; and (c) compare the proposed level of effort more easily to levels of effort proposed by other researchers on a “total compensation/total effort” basis. For all of these purposes, the 80% effort percentage that the university would be required to show under current NIH policies would have much less informational value.

Institutions faced with this problem sometimes attempt to deal with it by presenting the proposed effort both ways. For instance, using the hypothetical described above, an institution might use the 30% effort figure in the proposal budget, but with a notation that if the effort were expressed in terms of the total effort compensated only by the university, the effort percentage would be 80%. This approach allows NIH to see the proposed effort both ways, but doing so invites potential confusion. In at least one instance where such an approach was taken, NIH informed the grantee that it would fund the researcher's salary only on the basis of the university salary (\$60,000 in the example), *and* only on the basis of the effort percentage included in the proposal budget (30% in the example). In terms of the hypothetical, in effect, NIH took the position that it would fund only \$18,000 of the faculty member's effort (30% of \$60,000)—

even though \$48,000 worth of real, university-compensated effort was clearly being proposed and would indisputably be provided. This odd and unfair result could have been avoided if the grantee had simply been allowed to propose on the basis of total compensation.

Inconsistent Treatment of Grantees

Grantees that have dual compensation systems are treated differently from grantees that do not, and it is difficult to justify the differences in treatment. As discussed above, dual compensation grantees are not permitted to maintain fully integrated effort reporting systems, and their clinical faculty members have a built-in disincentive to engage in research. In addition, dual compensation grantees are restricted to Institutional Base Salary amounts that do not necessarily reflect the true economic value of the faculty member, and are often compelled to present their salary and effort percentages in proposal budgets in a way that can be confusing and misleading, to their detriment.

There appear to be no good reasons for imposing these kinds of disadvantages on dual compensation grantees. In economic and practical terms, there may be no real difference between a dual compensation grantee and one that has decided to combine all compensation in a single paycheck. Any differences that do exist and are of consequence to NIH and other federal sponsors should be dealt with in their own right, rather than by imposing broad restrictions on virtually all dual compensation arrangements.

A WORD ABOUT “SEPARATE COMPENSATION” ARRANGEMENTS

Most of the discussion in this commentary relates to dual compensation arrangements. The issues that arise in connection with “separate compensation” arrangements (in which a legal entity other than the grantee pays the entire salary of some or all grant personnel) are similar in origin, but different and generally less problematic in effect. **Example B** and **Example E** represent typical separate compensation arrangements. In both examples, all of the entities involved may have personnel working on their grants who hold appointments in the grantee institution, but whose salary is paid completely by a separate institution. In such cases, again, the NIH interpretation of “Institutional Base Salary” would normally preclude the grantee from budgeting and charging for the salaries of such employees, because the grantee does not pay their salaries. This creates difficulties of various kinds.

The issue here is not whether it is permissible for individuals who are not employed by the grantee to hold positions of responsibility with respect to grant performance. Generally speaking, grant personnel are employees of the grantee, but NIH recognizes that there may be circumstances in which even the Principal Investigator on an NIH grant may be employed by an institution other than the grantee (NIH Grants Policy Statement, p. 26). In such circumstances NIH requires “a formal written agreement with the PI that specifies the official relationship between the parties,” and NIH reserves the right to assess “whether the arrangement will result in the organization being able to fulfill its responsibilities under the grant” (Ibid.). There is, however, no *per se* prohibition of such arrangements.

The principal question is how such personnel should be presented in grant proposals, and how to charge NIH and other grants for their services. The “Personnel” sections of the PHS 398 budget forms state that they relate to personnel of the “Applicant organization only.” If these individuals cannot be listed in the “Personnel” section of the grant budget, however, there does not appear to be any alternative way of presenting them that fully and accurately reflects their true status. Such personnel rarely qualify as “subcontractors,” because they are not assigned a discrete sub-portion of the work and required to assume responsibility and risk in carrying it out, as a subcontractor would. Also, there are potentially undesirable

F&A implications of treating such personnel as subcontractors, depending on the dollar amount of their services. It might be possible to treat the personnel as “consultants,” although their true role is normally to participate actively in the project team, not as an outside consultant. The “consultant” designation seems particularly ill-suited to arrangements in which the non-employee is the Principal Investigator on the grant.

Often it is suggested that the effort of such personnel should be shown as “purchased services.” The term “purchased services” is not a defined term under the OMB Circulars or NIH policies, but it appears to mean “employee-like services provided by non-employees.” This designation is at least accurate, but if it were used it would still require the grantee to show the personnel in question outside the personnel section of the proposal budgets. It is also unclear whether the grantee’s F&A rate would be applied to the full dollar amount of such services, as it would in the case of employee compensation.

The preferable approach, and the one that seems most consistent with the realities of how such employees of closely affiliated entities are used in research, is to allow them to be presented as “Personnel,” with a requirement that their employment by another entity be clearly noted in the proposal. Inclusion of such an individual in the “Personnel” section should carry with it the obligation on the part of the grantee to ensure that the effort of the individual is tracked and documented in a compliant manner, either directly or by exchanging effort information with the individual’s employer. Assuming that this obligation is met, there does not appear to be any purpose served by requiring that such individuals be listed separately as subcontractors, consultants, or purchased services personnel.

WHAT PURPOSES ARE SERVED BY NIH’S CURRENT TREATMENT OF DUAL AND SEPARATE COMPENSATION?

There is nothing in NIH’s published policies that suggests a reason for restricting Institutional Base Salary to salary that is paid in the form of a grantee organization paycheck. As dialogue continues on this subject between NIH and the research community, possibly the reason or reasons for NIH’s policies will become more clear. In the meantime, however, we are left to speculate as to what the basis for the policies might be.

Ensuring that Grantees are Authorized to Charge for the Salary Costs Incurred by a Separate Legal Entity?

NIH obviously has a legitimate interest in ensuring that grantees do not claim reimbursement for salaries that they do not pay *and are not authorized to charge*. At a minimum, grantees claiming reimbursement for salaries paid by a separate legal entity must be prepared to demonstrate that they have been authorized by that separate entity to submit such claims.

NIH has dealt with this problem in the context of “affiliated organizations” by requiring the grantee to show either (a) that it has been charged for and is legally obligated to pay for the services in question, or (b) that it has been authorized in writing by the separate entity to claim and retain reimbursement for the salary costs incurred by the separate entity (NIH Grants Policy Statement, p. 87). It would appear that similar provisions would be both appropriate and sufficient in other dual and separate compensation arrangements.

Preventing “Excessive” Institutional Base Salary Amounts?

One possible NIH concern may be that allowing grantees to combine separate sources of compensation would result in excessively high amounts of Institutional Base Salary. If in fact this is one of the reasons for the restriction on dual compensation arrangements, there are three possible responses. First, whatever may have been the case when the restriction was first imposed, the statutory NIH cap on compensation now protects NIH from being charged at an “excessive” salary rate. Second, the fact is that in most if not all cases it is the *combined* salary, not any of its sub-components, that best reflects the economic “value” of the employee; in such cases the combined salary is not “excessive,” but demonstrably reasonable in market terms.

Third, the fact that the combined salary is greater in amount will be partially, if not totally, offset by the fact that the salary will be allocated over a broader range of activity through a payroll allocation system based on total effort. Consider again the hypothetical of a clinical faculty member who receives \$90,000 in clinical salary and \$60,000 in university base salary, and works 45 hours and 30 hours, respectively, in clinical and non-clinical activity. If only the university base salary is included in Institutional Base Salary and 50% of his non-clinical (university) effort is devoted to an NIH grant, the grant will be charged \$30,000. If, on the other hand, the entire \$150,000 is treated as Institutional Base Salary, then only 20% (15 hours a week divided by 75 hours a week) of that amount will be charged to the NIH grant, also resulting in a grant charge of \$30,000. It is true that if the faculty member is being compensated for clinical activity at a higher rate relative to time spent, then combining the two salaries into one Institutional Base Salary will tend to increase the charges to the NIH grant. However, such a result represents nothing more than NIH’s reimbursing of the grantee at a salary rate that reflects the faculty member’s true compensation and economic value.

Moreover, where the combined salary exceeds the NIH cap, allowing dual compensation arrangements may actually result in a *lower* charge to NIH grants. For example, assume a faculty member with a university base salary of \$70,000 and a clinical salary of \$105,000, for 30 hours a week of university work and 45 hours a week of clinical work. If the faculty member works 15 hours a week on an NIH grant and Institutional Base Salary is restricted to the university base salary, the university will recover \$35,000 in reimbursement for his salary. However, if the two salaries are combined for an Institutional Base Salary of \$175,000, the university will be restricted to a recovery of 20% of the NIH cap rate of \$171,900, or only \$34,380.

Obviously, different hypothetical numbers will produce different results, but the following facts remain: (a) the NIH cap will protect NIH from being charged “excessive” salaries in dual compensation situations; (b) fully integrated effort reporting and payroll allocation will at least partially offset any higher salary charges to NIH; and (c) to the extent that a dual compensation arrangement actually causes NIH to provide greater reimbursement for a faculty member’s salary, this will only occur because the dual compensation salary represents the faculty member’s true economic value—which after all *should* be the basis for reimbursement.

Avoiding Double Reimbursement of the Same Salary?

Where the total compensation of a grantee employee is supported both by the grantee and a separate legal entity, and the separate entity is itself engaged in sponsored research, allowing both sources of salary to be included in Institutional Base Salary creates a risk that some part of the employee’s salary will be reimbursed twice. For example, where 75% of an employee’s effort relates to an NIH grant, in a dual

compensation arrangement the grantee would charge NIH for 75% of the employee's salary, including 75% of the salary funded by the separate entity. If the separate entity were also to use the same employee on one of its NIH grants and charge the grant for 50% of the employee's salary, there would clearly be an overlap in reimbursement.

It should be noted that the risk of such overlap is by no means limited to dual compensation arrangements. Even where grantee employees receive only one paycheck, there is no inherent reason to assume that more than 100% of an employee's time and effort will not be charged out to sponsored agreements and other activities. What prevents this from happening in a single compensation arrangement is an adequate system of tracking effort and other support. Exactly the same is true of a dual compensation arrangement.

The key to avoiding such overlap and duplication in a dual compensation arrangement is to require that the effort reporting systems of the grantee and the other "paymaster" are sufficiently coordinated. In the case of VA affiliations, for example, NIH requires a certification "that there is no possibility of dual compensation for the same work." In order to provide such a certification, a grantee must be able to verify, through some sort of coordination of effort reporting, that NIH is not being charged for effort (and the associated salary) that is being separately compensated by the VA. A similar requirement would be appropriate in other dual compensation arrangements.

Avoiding Diminished Grantee Control over Employees Paid by a Separate Entity?

It would certainly be reasonable to ask whether a grantee whose grant personnel are compensated in whole or in part by a separate legal entity is able to exercise the necessary control over such personnel for grant compliance purposes. To be sure, the power to set salary is an important source of control. There is no inherent reason to assume, however, that such leverage is not present in dual compensation arrangements. Even where employees receive salary from two or more sources, very often the overall amount of the salary is established on an integrated basis, taking into account the full range of the employee's activities. (See **Example A** and **Example C** above.) In such cases at least, the "dual" nature of the compensation arrangement in no way diminishes the ability of the grantee institution to control salary levels.

It should also be noted that control of salary levels is not the only tool, or even the most effective tool, that grantees have available to them to help ensure compliance with grant requirements. The power to disapprove grant proposals or to deny further participation in research, the power to impose discipline, and the power to grant or withhold discretionary funding—to name just a few examples—are all at least as potent weapons as the power to set salaries. On the more positive side, compliance training, adequacy of support staff, and implementation of effective compliance policies and procedures are all tools that are just as available to a grantee in a dual or separate compensation arrangement as they are to any other grantee.

As noted above, NIH itself expressly permits arrangements in which even the Principal Investigator on a grant is employed by an institution other than the grantee (NIH Grants Policy Statement, p. 26). Quite appropriately, NIH cautions that such arrangements may raise questions as the ability of the grantee organization to fulfill its grant obligations. Any grantee that proposes to use non-employee personnel in key grant positions must be prepared to satisfy NIH that the proposed arrangement will not compromise the grantee's performance and compliance ability. Where separate compensation arrangements arise in the context of close research affiliations, there should be a research affiliation agreement under which

each party commits to uphold the performance and compliance obligations of the other when its employees are performing on the other party's grants. With appropriate safeguards and procedures of this sort, the use of non-employees, or the use of employees paid only in part by the grantee, does not appear to be inconsistent with NIH's compliance objectives. That being the case, there does not appear to be any compliance-related reason for prohibiting the inclusion of non-grantee compensation in Institutional Base Salary.

Keeping Apples and Oranges Apart?

Although most dual compensation arrangements seem completely consistent with NIH's interests, there may well be some situations in which the separate sources of personnel compensation should remain segregated. One possible example would be a VA affiliation arrangement (see **Example D**), in which faculty members receive full or part-time VA salaries in addition to their full-time (or in some cases, part-time) university salaries.

Even in the case of a VA affiliation, there could be some advantages to integrating the two sources of compensation and the corresponding effort. Most importantly, an integrated system of effort reporting, covering both university and VA effort, would help to reduce inconsistencies in reporting of effort and make overlaps between the two appointments less likely.

On the other hand, since the VA salary is paid by a federal agency, there is no circumstance in which it would be permissible to combine the two components of salary for purposes of charging NIH or other federal grants. Moreover, the VA's own compensation system requires a separate accounting for the time and effort expended by a VA employee in carrying out his or her VA duties. That being so, in the special case of a VA affiliation it would probably not be feasible to combine the VA and university salaries in a single Institutional Base Salary.

There may be other situations where, for similar or other specific reasons, it may be necessary or appropriate to maintain a clear dividing line between dual sources of compensation and their associated effort. However, there does not appear to be a justification for prohibiting all dual compensation arrangements simply because some of them might not be workable or acceptable.

THE CURRENT EXCEPTIONS ARE TOO NARROW

As indicated above, there are currently two exceptions to NIH's general rule restricting Institutional Base Salary to amounts paid by the grantee itself. As these exceptions are currently interpreted and applied, however, it is not clear whether most dual or separate compensation arrangements that exist today would qualify under either exception.

There is a good argument that the "affiliated organization" exception (NIH Grants Policy Statement, p. 87) should apply to situations in which there is an actual research affiliation between the grantee and a separate legal entity. There is some concern, however, that NIH may read this exception narrowly, to apply only to arrangements involving research foundations acting as an intermediary for universities. Although I am aware of a number of situations in which NIH has, in the past, read this provision more broadly, there is no guarantee in today's uncertain climate that it will continue to do so.

The second exception—the so-called DHHS "common paymaster" exception—is one for which few dual compensation arrangements would be able to qualify. Although grantees would presumably accept the

requirement of an integrated effort reporting system corresponding to total effort and allocating total compensation, few grantees are in a position to act as a common paymaster, much less to “guarantee” the non-university component of salary. It appears, therefore, that unless this exception is liberalized it will be of very limited value.

CONCLUSION AND ELEMENTS OF A PROPOSED SOLUTION

The basic premise of this commentary is that both the government and the research community would be well served by a more pragmatic and flexible approach to reimbursement of researcher compensation. The issue is not whether a payroll allocation approach based on total combined compensation is better or worse, or more or less compliant, than an approach based solely on the grantee-paid component of compensation. Either approach can succeed—and either can fail—depending on the circumstances of its use and how it is carried out. A university payroll allocation system based solely on university base salary, where there is a sufficiently clear delineation between what activity the university pays for and what it doesn’t, can have significant advantages in terms of compliance and efficiency. For some institutions, where there is a significant organizational distance between clinical activity and the non-clinical activity paid for by university base salary, no other approach is practicable or desirable, and no purpose would be served by requiring them to change their current approach. However, other institutions, where the entities providing dual or multiple sources of salary are more closely integrated, may be in a good position to allocate total salary on the basis of total professional effort, and may be prepared to build an integrated effort reporting system capable of supporting such an approach. Any solution to the problem addressed in this commentary must be able to identify the circumstances under which the latter approach is acceptable.

Although it is premature to propose such a solution in detail, its most basic elements should, in my view, include the following:

- Redefining “Institutional Base Salary” to provide that, in certain circumstances, it may include compensation paid by an organization other than “the applicant organization.” No grantee would be required to include such additional compensation in Institutional Base Salary, but those who satisfy certain criteria (see below) should be permitted to do so on request.
- Allowing dual compensation arrangements in the clinical practice plan setting where compensation is established on an integrated basis, taking into account all professional activities of the employee, and effort is tracked on an integrated basis by the grantee on the basis of reliable information obtained from the practice plan. In these arrangements, Institutional Base Salary would include both the clinical and non-clinical components of compensation (perhaps excluding bonus payments that are strictly related to clinical practice). Again, no grantee would be required to combine the two components of salary.
- Allowing dual or separate compensation arrangements between affiliated organizations, pursuant to the existing NIH Grants Policy Statement provision on “Services Provided by Affiliated Organizations.” Participants in such arrangements would be required to maintain coordinated effort reporting systems to prevent duplication of effort and reimbursement. If necessary, the requirements of this exception could be clarified and tightened to ensure that any NIH compliance control concerns are satisfied.

- Identifying special situations (such as VA affiliation arrangements) where dual compensation may not be included in Institutional Base Salary.

It is clear that the effort reporting mechanisms necessary to ensure adequate coordination between or among separate organizations would have to be developed with considerable care. Indeed, one of the conditions of permitting inclusion of dual compensation in a single Institutional Base Salary should be the existence of such an “inter-entity” effort system, perhaps meeting certain specified requirements. If such requirements can be met, however—and I believe that many grantees involved in dual or separate compensation arrangements will be fully capable of meeting them—then a grantee that seeks to include dual or separately paid compensation in Institutional Base Salary should be allowed to do so.

Flexibility must be the guiding principle in developing any new policy or guidelines in this area. Any new policy must recognize the wide variety of different compensation arrangements among NIH grantees. The handful of examples of compensation arrangements included in this commentary, while broadly representative of compensation arrangements that actually exist, do not even begin to reflect the very large number of such arrangements and the many differences among them. Virtually all of these arrangements have been established for important and valid economic, legal, organizational or cultural reasons, and cannot easily be changed without considerable damage or cost.

In the absence of a compelling Government reason for a blanket rule disfavoring dual or separate compensation arrangements, I submit that each such arrangement should be evaluated on its own terms. If the arrangement results in (a) an Institutional Base Salary that is reasonable in market terms, (b) a workable system for tracking personnel effort, and (c) a reasonable assurance that the grantee’s performance and compliance obligations will be fully satisfied, then the arrangement should be permitted.

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