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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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RELEASED

B-170688

2 addressees

JAN 17 1972

C1 Dear Senator Percy: 2A

Your letter of April 26, 1971, referred for our consideration a letter dated April 5, 1971, from your constituent, Mr. Sheldon I. Dorenfest, president of Compucare, Inc. Mr. Dorenfest commented on information included in our previous report to Congressman Robert McClory (B-170688, dated January 8, 1971) and requested that we consider certain other issues related to the use of Government funds to develop products which are subsequently acquired by large companies to the detriment of smaller companies such as Compucare.

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In his letter Mr. Dorenfest stated that McDonnell Automation Company (a division of McDonnell Douglas Corporation) had been provided an advantage over its competitors by the acquisition of the data processing division of the Sisters of the Third Order of St. Francis. (The Third Order is a religious group which operates 11 hospitals in Illinois, Iowa, and Michigan.)

Mr. Dorenfest indicated that, in his view, an even more significant advantage than the premature disclosure of information to McDonnell Automation was provided by McDonnell Automation's (1) ability to demonstrate and market a partially operational patient-care information system using Third Order facilities and (2) employment of former Third Order employees who were familiar with the operation of the data processing division.

In addition to commenting on Mr. Dorenfest's views, we are furnishing information relating to the marketability of the patient-care information system and to the legality of the contractual arrangements between the Third Order and McDonnell Automation.

ABILITY TO DEMONSTRATE AND/OR MARKET FINANCIAL CONTROL AND PATIENT-CARE INFORMATION SYSTEMS

Department of Health, Education, and Welfare (HEW) records show that, since 1964, the Third Order has had an operational automated financial control information system. The

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system, connected by a central computer to several hospitals in the Midwest, provides for such functions as patient billing, accounts payable, payroll, and financial reporting.

On January 1, 1967, the Public Health Service of HEW awarded a grant to the Third Order for a research project entitled "Demonstration of a Shared Hospital Information System." The grant provided for the demonstration of the use-- by a group of participating hospitals--of a patient-care information system, connected by the central computer, to provide communication between various hospital departments and between physicians and hospitals and to automate patient records and hospital procedures for such functions as admittance, laboratory, and radiology.

In April 1969, near the end of the original 3-year project period, the Third Order submitted a proposal for a 2-year renewal of the grant and requested additional Federal funds. This proposal included a report on the progress made by the Third Order under the initial grant. According to this report the admittance function had been completed and the laboratory and radiology functions were scheduled for completion during 1969. The report also noted that certain other functions--pharmacy, central supply, dietary services, and physical therapy--were scheduled for installation in 1970.

In March 1970, after review and consideration by an HEW advisory group, the Third Order's proposal for a 2-year renewal was officially denied because (1) progress had been unsatisfactory, (2) continuation plans as stated in the proposal were vague, and (3) effective contributions by the Third Order to the Government's need for an evaluated, transferable hospital information system were improbable. The project period, however, was extended by HEW through January 31, 1971, without additional funds to permit the Third Order to complete certain analyses and to issue a final report on the project.

According to data furnished to us by the principal investigator of the grant project, at March 1, 1970, only the

admittance function of the patient-care information system was in full operation at three pilot hospitals operated by the Third Order; the laboratory and radiology functions did not become fully operational at the pilot hospitals until May 1970.

On March 1, 1970, the Third Order transferred to McDonnell Automation, without prior HEW knowledge, its entire data processing operation, which included the financial control system and the patient-care information system. At the same time McDonnell Automation entered into a long-term service contract with the Third Order to provide all data processing services required by the hospital group.

The computer programs developed for the patient-care information system were transferred to McDonnell Automation by the Third Order which waived and disclaimed any proprietary interest in these programs. As a result of these transactions, McDonnell Automation is able to demonstrate and market an ongoing financial control information system and to demonstrate a partially operational patient-care information system.

Our previous report on this matter recognized that McDonnell Automation may have gained some advantage over its competitors by using certain hospitals operated by the Third Order as demonstration sites to market the systems. We have not determined, however, that McDonnell Automation's ability to demonstrate and market the financial control system has been enhanced by virtue of having a partially completed patient-care information system.

EMPLOYMENT OF FORMER THIRD ORDER EMPLOYEES
BY MCDONNELL AUTOMATION

We stated in our previous report that we believed that the benefits obtained from the investment of Federal funds should be available, to the maximum extent, to all potential beneficiaries on an equal basis. In view of this belief, we asked HEW to explore the advisability of establishing grant conditions which would prevent (1) the premature disclosure of

valuable information developed with Federal funds to anyone who could use it for the purpose of making a profit and (2) the transfer to a profitmaking company, during the period of a grant or within a reasonable period thereafter, of an organization or facility, or any significant part thereof, which had been developed or enhanced with the use of Federal funds.

In May 1971 HEW informed us that it had concluded that the facts in this case did not warrant a change in grant policy as suggested by us. HEW stated, however, that:

"The most significant advantage to McDonnell in this situation was the voluntary transfer of personnel familiar with the system from the Third Order to McDonnell. This voluntary transfer permitted McDonnell to offer a system that was operational-- something that other companies could not do. Although this did give McDonnell an advantage over others, we are not aware of any action that should be taken to restrict the rights of employees to move voluntarily from one organization to another."

In November 1971 HEW informed us that further consideration had been given to the desirability of issuing additional policy instructions on the question of premature disclosure of valuable information developed or supported by HEW grant funds. HEW concluded, however, that no benefit would be served by additional policy treatment of this subject. It is HEW's opinion that present policies, when considered in the light of its overall philosophy that services or materials deriving from grant programs be used for the public benefit, should not be made more restrictive.

We believe that the control over grantee activities is very difficult, particularly when grant funds are provided for experimentation purposes. Stringent control provisions placed in such grants could very well serve as a detriment to the accomplishment of the purpose of the grant. In this regard we know of no reasonable or effective way of preventing the transfer of employees in situations similar to the one discussed in this report.

MARKETABILITY OF PATIENT-CARE INFORMATION SYSTEM

We have had a further discussion on the marketability of the patient-care information system with the former principal investigator who was responsible for the scientific and technical direction of the grant project. This individual is now the Manager, Hospital Services Division, McDonnell Automation Company, and is presumably knowledgeable as to the status and prospects of the patient-care information system, including estimates of development costs.

The former principal investigator reaffirmed his previous comments as to the marketability of the patient-care information system and stated that his opinion was shared by McDonnell Automation. He expressed the opinion that most hospitals could not justify an investment in a patient-care information system consisting only of admittance, laboratory, and radiology functions--which were in operation at three Third Order pilot hospitals. Moreover he believed that the system could not be considered marketable to hospitals until completion of the pharmacy function which included medication scheduling.

The former principal investigator informed us that McDonnell Automation had not realized any outside sales revenue from the patient-care information system, except for the income from the three Third Order pilot hospitals, and that it probably would not realize any outside income until 1972. He stated that McDonnell Automation had incurred substantial costs for system development after March 1, 1970, the acquisition date of the Third Order's data processing division, and that additional expenditures for the development of the patient-care information system were anticipated. The Controller of the Third Order informed us that two of the three pilot hospitals had been considering the discontinuance of the patient-care information system, apparently because of its cost.

REVIEW OF CONTRACTUAL ARRANGEMENTS BETWEEN
THE THIRD ORDER AND MCDONNELL AUTOMATION

We reviewed the contractual arrangements between the Third Order and McDonnell Automation that resulted in the

transfer of the data processing operation to determine whether any provisions contained therein were legally objectionable or at cross-purposes with the basic grant agreement between HEW and the Third Order.

Included in the contractual arrangements were provisions in a royalty agreement, which stipulate that the Third Order is to receive from McDonnell Automation, during a specified period, certain royalties which would, in part, be based on sums received by McDonnell Automation from the sale of the data processing system.

A provision in the sale and acquisition agreement also stipulates that, during the period of the royalty agreement, the Third Order not make public certain information developed concerning the data processing system. According to this provision the Third Order has agreed:

1. That all new applications of the Shared Hospital Information System which were developed by McDonnell Automation in conjunction with any Third Order hospital should remain the sole property of McDonnell Automation.
2. Not to disclose to any third party any application, documentation, technical data, report, or other information which would assist such third party in its development, manufacture, or ability to develop any package to perform the data processing services being developed or marketed by McDonnell Automation.

Excluded from this provision were Phase I developments (i.e., admittance, laboratory, and radiology functions) of the Shared Hospital Information System, which were developed by the Third Order under the HEW grant. Also, as previously pointed out to you, it was expected that, pursuant to the grant, the Third Order would issue its final report to HEW in 1971. This report was issued in January 1971.

Our review of these provisions disclosed no basis for concluding that either the Third Order or McDonnell

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Automation did anything which was unlawful or at cross-purposes with the terms of the grant agreement.

With regard to the lawfulness of the basic agreement between the Third Order and McDonnell Automation, we are not aware of any general statute which precludes grantees from entering into contracts with third parties that may involve information or data developed in a grant. Moreover, in our opinion, such a contract is appropriate so long as the grantee's responsibility to the grantor is met and the third-party arrangement does not lessen the value to the grantor of the grantee's performance under the grant. In view of the issuance of a final report by the Third Order, we are not aware of any terms of the HEW grant to the Third Order that have not been met.

We believe that such arrangements as those existing between the Third Order and McDonnell Automation may initially raise questions as to whether there has been full compliance with grant administration policy as it relates to public disclosure of information developed under Federal grants. Although we find nothing in the agreement between the Third Order and McDonnell Automation which is unlawful or at cross-purposes with the grant agreement between HEW and the Third Order, we continue to believe that McDonnell Automation gained a potential advantage over its competitors as a result of its acquisition of the Third Order's data processing division which was developed to some extent with HEW grant funds.

HEW, Third Order, and McDonnell Automation officials have not been given an opportunity to comment on the matters discussed in this report.

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As requested, the material enclosed with your letter is returned.

Sincerely yours,


Comptroller General
of the United States

Enclosure

The Honorable Charles H. Percy
United States Senate