



OFFICE OF LEGAL AFFAIRS

To: Operations and Regulations Committee

Through: Victor M. Fortuno, Vice President and General Counsel 

From: Mark Freedman, Senior Assistant General Counsel 

Re: Summary and Analysis of Comments on Notice of Proposed Rulemaking on Alternative Sanctions, 77 Fed. Reg. 4,749 (January 31, 2012)

Date: June 12, 2012

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On January 31, 2012, LSC published a Notice of Proposed Rulemaking (NPRM) in the Federal Register. The notice proposed three significant changes in the sanctions available to LSC: (1) the adoption of reductions in funding of less than five percent, (2) the imposition of special grant conditions during the term of a grant, and (3) the extension of non-audit related suspensions from a 30-day maximum to a 90-day maximum. All of the comments received have been reviewed and posted online in the Open Rulemaking page of the Regulations section of LSC.gov.

This memorandum provides a section-by-section overview of the proposed changes in LSC's rules with the comments, staff analysis, and options for the Committee's consideration. For purposes of this memorandum, Management is not making specific recommendations, although the analysis and options identify some of Management's preferences and concerns. The options are limited to those that Management considers workable in light of the stated purpose of the NPRM. In all cases, the other options are to close the rulemaking without any changes, to proceed with changes proposed in the comments, or to adopt the rule as published in the NPRM.

LSC received nineteen comments. Generally, only the comment of the Office of Inspector General (OIG) supported the proposal as written, although the OIG recommends a rule providing for suspensions to remain in place until corrective actions are taken, and the OIG questioned whether the proposed mid-term special grant conditions were unduly restricted. All eighteen of the other comments opposed the proposed changes. Those comments include ones from LSC recipients, coalitions of legal aid programs, the National Legal Aid and Defender Association (NLADA), the American Bar Association Standing Committee on Legal Aid and Indigent Defendants (SCLAID), and the New York State Bar Association Committee on Legal Aid. Attached is a table identifying who submitted comments and on behalf of what organizations. The eighteen opposing comments also recommended changes to the proposed language if LSC proceeds with rulemaking. These comments had a number of common themes. Fifteen of the comments were two or three pages. The ABA, NLADA, and Colorado Legal Services provided more extensive comments (five to seven pages). The OIG's comments in support of the rule were sixteen pages in length.

Management continues to support a rulemaking to adopt the three changes identified in the NPRM. Management considers the proposed changes to strike a good balance among the competing issues involved but is amenable to modifying some details to address some of the concerns raised in the comments.

All of the comments in opposition to the proposal expressed concern about the impact on client services, the possible abuse of discretion by LSC, and the lack of a clear need for these options when LSC already has other tools for compliance enforcement at its disposal. These eighteen comments stated that existing options are sufficient, there is no need for new options, and that the proposals create too great a risk of a loss of client services to justify their adoption. These concerns address the underlying question whether LSC should adopt any new or changed enforcement mechanisms. The OIG asserted the need for the new options and supported the adoption of them as striking the correct balance between client services and enforcement concerns. The OIG offered its descriptions of how these options would improve LSC oversight while providing adequate standards and process.

The proposed regulatory changes are set out below with additions underlined and deletions in ~~strikeout~~. Each section of proposed text is followed by a summary of the comments, staff analysis, and options.

The concerns regarding client services were not specific to any of the regulatory language itself. Most of the comments expressed concern about the effect on clients if LSC imposes a reduction in funding of less than five percent, and SCLAID suggested adding the effect on clients as a criterion. This concern highlights the dilemma LSC faces with any monetary sanction. On the one hand, a recipient that is not complying with the LSC rules may pose risks to itself, its clients, and the national legal aid program, and, as the OIG observed, impermissible activities divert funds from permissible ones. In order to be effective, monetary sanctions have to be calibrated to have an effect on the recipient in question, and the threat of monetary sanctions needs to be serious enough to have a preventive effect. On the other hand, all monetary sanctions reduce the resources available to serve clients and therefore may have an adverse effect on client services. It is likely that a monetary sanction that is sufficient to have a punitive and deterrent effect will also affect client services in some way. Management recognizes the desirability of avoiding reductions in client services when possible, and thus the proposal is not to eliminate the many non-monetary options that LSC currently can use, usually before having to resort to a reduction in funding. The mere availability of monetary sanctions may have the necessary deterrent effect.

## SECTION-BY-SECTION ANALYSIS

### **Sec. 1606.2 Definitions.**

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(c) Limited reduction in funding means a reduction in funding of less than 5 percent of a recipient's current annual level of financial assistance imposed by the Corporation in accordance with § 1606.15 of this Part.

\* \* \* \* \*

(e)(1) Termination means that a recipient's level of financial assistance under its grant or contract with the Corporation will be reduced in whole or in part prior to the expiration of the term of a recipient's current grant or contract. A partial termination will affect only the recipient's current year's funding, unless the Corporation provides otherwise in the final termination decision.

(2) A termination does not include:

(i) A reduction of funding required by law, including a reduction in or rescission of the Corporation's appropriation that is apportioned among all recipients of the same class in proportion to their current level of funding;

(ii) A reduction or deduction of LSC support for a recipient under the Corporation's fund balance regulation at 45 C.F.R. Part 1628;

(iii) A recovery of disallowed costs under the Corporation's regulation on costs standards and procedures at 45 C.F.R. Part 1630;

(iv) A withholding of funds pursuant to the Corporation's Private Attorney Involvement rule at 45 C.F.R. Part 1614; or

(v) A limited reduction of funding as defined in this paragraph.

~~(v) A reduction of funding of less than 5 percent of a recipient's current annual level of financial assistance imposed by the Corporation in accordance with regulations promulgated by the Corporation. No such reduction shall be imposed except in accordance with regulations promulgated by the Corporation.~~

<b>Summary of Comments</b>
SCLAID noted that the proposed changes to the definitions section were confusing.
<b>Staff Analysis of Comments</b>
The comment accurately reflects the need for some technical corrections to the numbering and structure of the changes. The NPRM added a new subsection (c), but did not state that the existing subsections (c) and (d) would be renumbered as (d) and (e). The new proposed subsection (e) is thus an amendment to the existing subsection (d).
<b>Options</b>
Staff can make the necessary adjustments in the next version for publication without substantive changes.

**Sec. 1606.3 Grounds for a termination.**

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(b) A determination whether there has been a substantial violation for the purposes of paragraph (a)(1) of this section, and the magnitude of any termination in whole or in part, will be based on consideration of the following criteria:

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See discussion of proposed section 1606.15 below.

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**Sec. 1606.13 Interim and termination funding; reprogramming.**

(a) Pending the completion of termination or limited reduction in funding proceedings under this part, the Corporation shall provide the recipient with the level of financial assistance provided for under its current grant or contract with the Corporation.

(b) After a final decision has been made to terminate a recipient's grant or contract or to impose a limited reduction in funding, the recipient loses all rights to the terminated or reduced funds.

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(d) Funds recovered by the Corporation pursuant to a termination or limited reduction in funding shall be ~~used in the same service area from which they were recovered or will be~~ reallocated by the Corporation for basic field purposes at its sole discretion.

<b>Summary of Comments</b>
<p>LSC received four comments on proposed paragraph (d). The comments suggested that any funds recovered by the Corporation under this provision should be returned to the same service area.</p> <p>One comment suggested that the regulation should specify that such recovered funds be used for basic field purposes.</p> <p>One comment suggested that LSC should re-review its authority to use recovered basic field funds for grants to service areas other than the service area that the funds were originally awarded to under the statutory distribution formula.</p> <p>The OIG recommended adoption of the rule without any specific changes to or discussion about this section. The OIG did, however, discuss the impact of both grantee noncompliance and the proposed rule on the client services that LSC is authorized to fund.</p>

<b>Staff Analysis of Comments</b>
<p>Longstanding LSC practice is that funds returned to LSC, such as disallowed costs, are maintained for basic field purposes, but that they are not designated solely for the service area that they were</p>

returned from. Rather, as reflected in the current language of Part 1606, LSC may look to whether recovered funds could be used in the same service area in a reasonable fashion, but LSC always has the discretion to use the funds for another service area. Recovered funds are currently used for emergency and special grants to existing LSC recipients.

The current rule does not require that LSC return the funds to the same service area; it allows LSC to reallocate recovered funds “for basic field purposes.” The proposed change in the language would continue LSC’s existing discretion regarding the use of recovered funds for basic field purposes. It would remove the explicit reference to the option of using those funds in the same service area, but LSC would retain the discretion to do so. This discretion is important to cover the variety of situations that may occur. When a reduction in funding is imposed, the same recipient continues to serve the same service area. Thus, returning the funds taken as a sanction to the same service area would often mean that the sanctioned recipient would get the funds back. This could vitiate the sanction and undermine the deterrent effect. This is especially a concern because LSC usually does not receive applications for a service area from any entity other than the current provider. Thus, the next recipient for a service area is likely to be the current recipient. Nonetheless, a new recipient might be selected and/or LSC might fully terminate a recipient. In those situations it may be appropriate for LSC to use the recovered funds to make a special start-up award to the new recipient for that service area.

The proposed regulation expressly states that any such recovered funds “shall be reallocated by the Corporation for basic field purposes.” The comment on that issue misread the text. No comments recommended changing that provision.

With respect to the distribution formula question, LSC’s longstanding position has been that the distribution requirement is met through the initial distribution of funds during the grant award process. Upon recovery, LSC has discretion to determine the best use of the funds within basic field purposes. This approach harmonizes the requirement that LSC distribute basic field funds in a per-capita manner with the requirement that LSC enforce the rules and restrictions on LSC recipients. As discussed above, a rule that funds be returned to the same service area is likely to significantly undermine the effectiveness of the sanction.

### **Options**

Management is concerned about maintaining the flexibility to reallocate these funds in an appropriate fashion based on the facts of each case.

The rule or the preamble to the rule could state that the Corporation expects always to consider, as a discretionary matter, the option of returning the funds to the same service area. The rule or the preamble also could identify the types of factors that LSC could consider in determining what to do with the recovered funds and whether some or all of them will be directed back into the service area that they came from.

**Sec. 1606.15 Limited reductions of funding**

(a) The Corporation may, in accordance with the procedures and requirements set forth in this section, impose a limited reduction of funding by reducing a recipient's funding in an amount less than 5% of the recipient's current annual level of financial assistance.

(b) Grounds for limited reduction in funding. A limited reduction of funding may be imposed when the Corporation determines that termination in whole or in part of the recipient's grant is not warranted, but that there nevertheless has been a substantial violation by the recipient of an applicable provision of law, or a rule, regulation, guideline or instruction issued by the Corporation, or a term or condition of the recipient's current grant or contract with the Corporation.

(c) A determination whether there has been a substantial violation for the purposes of paragraph (b) of this section, and the magnitude of the limited reduction in funding, will be based on consideration of the criteria set forth in § 1606.3(b).

(d) When the Corporation has made a determination to impose a limited reduction in funding in accordance with this section, the Corporation shall provide a written determination to the recipient and the Chair of the recipient's governing body. The determination shall:

(1) State the grounds, the amount, and the effective date for the limited reduction in funding;

(2) Identify, with reasonable specificity, any facts or documents relied on as justification for the limited reduction in funding;

(3) Specify what, if any, corrective action the recipient can take to avoid the limited reduction in funding;

(4) Advise the recipient that it may request, within five business days of receipt of the determination, an informal meeting with the Corporation at which it may attempt to show that the limited reduction in funding should not be imposed; and

(5) Advise the recipient that, within 10 days of its receipt of the determination and without regard to whether it requests an informal meeting, it may submit written materials in opposition to the limited reduction in funding.

(e) If the recipient requests an informal meeting with the Corporation, the Corporation shall designate the time and place for the meeting. The meeting shall occur within five business days after the recipient's request is received.

(f) If the recipient neither requests an informal meeting nor submits any written materials in opposition to the determination, the determination will be deemed effective at the end of the 10-day period following recipient's receipt of the determination.

(g) If an informal meeting is conducted and/or written materials are submitted by the recipient, the Corporation shall consider any written materials submitted by the recipient in opposition to the limited reduction in funding and any oral presentation or written materials submitted by the recipient at an informal meeting. After considering such materials, the Corporation shall decide within 30 days whether the limited reduction in funding should become effective and shall notify the recipient and the recipient's Board Chair in writing of its decision.

### Summary of Comments

The OIG supported this proposed section as written, observing that (1) the rule would require that monetary sanctions be proportional to the severity of the violation and (2) the rule establishes a documented, seven-step process to provide reasonable protections against arbitrary, abusive, or mistaken application.

All of the other comments opposed this section as lacking in sufficient due process, as setting forth inadequate and vague standards for application, and because the imposition of any monetary sanction would hurt the recipient and have a negative effect on client services.

One comment noted a concern that a recipient would be sanctioned for a disagreement over the proper interpretation of a regulation.

### Staff Analysis of Comments

The proposed process is substantively the same as that used for suspensions, which has been in place for decades. LSC can suspend funding for up to 30 days, except for audit failures, for which suspensions last until the audit is completed. Suspensions are different from reductions in funding in that suspensions create temporary cash-flow problems, but ultimately the funds are provided to the recipient at the conclusion of the suspension (unless an audit is never submitted for audit-related suspensions). Reductions in funding, by their very nature, take away the funds without an expectation that they will be returned. Suspensions can withhold up to 100 percent of funding, while the proposed limited reductions in funding are capped at five percent of funding. Thus, depending on the circumstances, either could have a greater impact on a recipient.

The 2008 LSC draft proposal for limited reductions in funding included an additional step for appeals within LSC of limited reductions in funding. Providing such a step would make the procedures for limited reductions in funding more similar to Part 1630 disallowed costs procedures than to suspension procedures, but would add both time and complexity to the process of imposing a sanction. Management is open to adding such a step.

The comments regarding the inadequacy of the criteria did not note that these are the same criteria in the existing rule for the greater sanction of terminations of between five percent and 100 percent. For reductions in funding of less than five percent, the proposal adds a requirement that LSC determine that a termination proceeding is not warranted. Nonetheless, terminations of more than five percent of funding include the option of a formal hearing before an impartial hearing officer appointed by the LSC President. Presumably, the comments' concern regarding the criteria is connected to the concern about the lack of that formal review hearing before an independent party. The NLADA comments suggest that, at a minimum, the criteria should include a knowing and willful standard; be limited to violations of the Act, appropriations acts and regulations; and that the adverse impact on clients be taken into account.

These concerns could be addressed by adding a cross-reference to Part 1618, which sets out the circumstances in which suspensions and terminations can be considered. Section 1618.5(b) provides that:

Whenever there is substantial reason to believe that a recipient has persistently or intentionally violated the Act, or, after notice, has failed to take appropriate remedial or disciplinary action to insure compliance by its employees with the Act, and attempts at informal resolution have been unsuccessful, the Corporation may proceed to suspend or terminate financial support of the recipient . . . or may take other action to enforce compliance with the Act.

(Emphasis added.) Section 1618.2 defines “the LSC Act” as including LSC’s rules and regulations. Thus, LSC cannot impose any termination or suspension for insubstantial reasons. A cross-reference to Part 1618 would make it clear that these criteria apply to reductions in funding of less than five percent.

Additionally, LSC could make clear that the Part 1618 reference to remedial actions and informal resolution includes consideration of any appropriate reduction in funding of less than five percent. In circumstances in which a sanction is warranted, LSC and the recipient could reach an agreement on a reduction in funding rather than utilize the costly and time consuming process set out in the NPRM. A failure to agree on an appropriate reduction in funding could, itself, demonstrate that attempts at informal resolution have been unsuccessful.

The concern regarding effects on client services are addressed earlier in this memorandum.

Many comments stated or implied that recipients may have legitimate disagreements with LSC regarding the meaning of certain rules, or that LSC may not have provided clarity regarding the rules. Some comments stated that LSC has provided contradictory advice in the past, although they did not provide examples. This concern is largely addressed by the Part 1618 requirements discussed above that require more than a mere misunderstanding before proceeding to any termination or suspension. While recipients might not always agree with LSC’s interpretation of the rules, LSC must have the authority to enforce those requirements as it interprets them. Recipients are encouraged to seek clarifications from LSC, and LSC’s longstanding practice has been to address misunderstandings and confusion through corrective actions. As discussed in the NPRM, the reductions in funding of less than five percent are intended for those rare situations in which the existing enforcement options are insufficient because of a recipient’s failure to follow the applicable rules.

### Options

Staff could provide modifications to the proposed rule to specifically reference the Part 1618 standards. Staff could also add a review stage similar to the final appeal provided in Part 1630 for questioned costs.

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**Sec. 1618.5 Duties of the Corporation.**

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(b) Whenever there is substantial reason to believe that a recipient has persistently or intentionally violated the Act, or, after notice, has failed to take the appropriate remedial or disciplinary action to insure compliance by its employees with the Act, and attempts at informal resolution have been unsuccessful, the Corporation may proceed to suspend or terminate financial support to the recipient pursuant to the procedures set forth in ~~part 1612~~ parts 1623 and 1606, respectively; may impose Special Grant Conditions on the recipient during the grant year; or may take other action to enforce compliance with the Act.

**Summary of Comments**

The comments of the OIG did not object to adoption of special grant condition rule but observed that the imposition of special grant conditions is already within the Corporation's inherent grant-oversight authority and noted that the text of the proposal would limit the imposition of special grant conditions in a way that may not correspond to current practice. The OIG suggests that the language be revised to afford the Corporation more flexibility.

Only one other comment (NLADA) addressed this section, supporting the proposed change "if Special Grant Conditions have a reasonable basis and are imposed in a fair manner."

**Staff Analysis of Comments**

With regard to the OIG's comment, the NPRM proposed using the existing § 1618.5 threshold as the criterion for imposing a mid-term special grant condition (SGC). The OIG pointed out that this criterion may be too high for mid-term SGCs. The types of mid-term SGCs under consideration involve corrective actions to address actual violations found by LSC. As such, LSC is not proposing to add substantively *new* grant conditions; rather, for mid-term SGCs, LSC would want to require explicitly that the recipient take steps to correct a violation of the existing grant requirements. For example, alienage screening involves a complex set of rules for determining eligibility—some undocumented aliens are eligible (*e.g.*, victims of domestic violence) and some authorized aliens are not eligible (*e.g.*, temporary protected status). A recipient with inadequate screening procedures should correct them immediately. LSC is proposing that, in addition to LSC requiring corrective actions based on an OCE review, LSC could also immediately add those corrective actions as a mid-term SGC. LSC would like to have the option of making those corrective actions into SGCs at any time, rather than waiting for the next grant term to begin (usually in January of the following year).

Staff could draft a new mid-term SGC provision that would provide that mid-term SGCs are limited to correcting existing violations, and that LSC can impose them at any time after an LSC

determination of non-compliance through LSC's normal oversight process. Additionally, the preamble could further elaborate that mid-term SGCs are a part of LSC's overall progressive approach to addressing violations, which are sometimes resolved immediately by the recipient without further LSC action.

With regard to the NLADA comment, Part 1618 already imposes a standard that these options are available when there "substantial reason to believe that a recipient has persistently or intentionally violated the Act, or, after notice, has failed to take the appropriate remedial or disciplinary action to ensure compliance. . . ." This threshold in the NPRM addresses the concerns about reasonableness and fairness. Nonetheless, as described above, Management could move mid-term SGCs out of section 1618.5 to better tailor them to the situations in which Management would like to apply them.

### Options

Staff could provide revisions to the language to address the OIG's concerns.

### Sec. 1623.4 Suspension procedures.

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(e) The Corporation may at any time rescind or modify the terms of the final determination to suspend and, on written notice to the recipient, may reinstate the suspension without further proceedings under this part. Except as provided in paragraph (f) of this section, the total time of a suspension shall not exceed ~~30~~ 90 days, unless the Corporation and the recipient agree to a continuation of the suspension ~~for up to a total of 60 days~~ without further proceedings under this part.

### Summary of Comments

The OIG suggests that LSC should follow the pattern of the Common Grant Rule (the rule followed by all federal agencies administering federal grant money) permitting suspension pending the recipient's taking the necessary corrective action. The OIG argues that a definite time-limited suspension period will remain "less effective in producing prompt corrective action because the maximum suspension period is not inextricably linked to the grantees conduct."

All of the other comments opposed extending the maximum suspension period beyond 30 days because an extended suspension would cause grave financial harm to the grantee and negatively affect client service. One comment expressed concern that a recipient could have its funding suspended for 90 days because it had a different interpretation of a regulation than did LSC.

### Staff Analysis of Comments

The 90-day limit works in conjunction with the adoption of the funding reduction option, both of

which occur only after the Part 1618 thresholds have been met. Once a recipient has demonstrated an unwillingness or inability to comply, a permanent reduction in funding may be more appropriate than a continued suspension. If a 90-day suspension is insufficient to compel compliance, then stronger options are merited. LSC could commence reduction in funding procedures before the end of the 90 days. Although the suspended funding would be restored after 90 days, LSC would by then be prepared to impose more permanent funding actions. If a recipient is making genuine efforts and wishes to avoid a reduction in funding, it has the option of consenting to continuing the suspension past 90 days in order to complete compliance efforts.

The concerns about the effects on clients and interpretations of the LSC rules are discussed above.

### **Options**

The time limit for suspensions could be increased or decreased.