
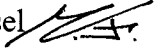




To: Operations and Regulations Committee
From: James J. Sandman, President 
Mark Freedman, Senior Assistant General Counsel 
Re: Management Response to Comments on the August 8, 2012, Further Notice of Proposed Rulemaking Regarding Enforcement Mechanisms
Date: December 19, 2012

INTRODUCTION

On September 18, 2012, LSC provided the Operations and Regulations Committee (Committee) with a summary, attached, of the comments received regarding the August 8, 2012, Further Notice of Proposed Rulemaking (FNPRM) for additional enforcement mechanisms. This memorandum provides Management's response to those comments. Meanwhile, Management is working on a draft final rule for the Committee's consideration at the January meeting. Management continues to recommend adoption of changes to the rules with a number of modifications based on the comments, recommendations from board members, and Management's own analysis. The draft final rule will address the Committee's suggestion that LSC add language regarding informal attempts at resolution of compliance issues within the Part 1606 process, and it will also address the Committee's request for improved clarity about the procedural processes in Part 1606.

LSC commenced this rulemaking to enhance, but not fundamentally alter, the existing regulatory structure for addressing significant compliance concerns. Management does not recommend changing that structure to add new standards or to provide for independent review outside of LSC. Rather, Management recommends completing the process that began in 1998 when LSC significantly revised LSC's enforcement mechanisms and created a new category for reductions of funding below five percent, for which LSC would need to adopt additional regulatory provisions. Longstanding LSC appropriations riders, first adopted in 1996, suspend and replace the LSC Act's requirements for enforcement mechanisms. Management believes that these changes reflect Congressional intent that LSC have more enforcement flexibility with post-1996 rules than it had with pre-1996 rules. Many of the alternatives recommended in the comments would result in rules with less flexibility than the pre-1996 rules, which Management believes would run contrary to Congressional intent and the objectives of this rulemaking.

The proposed changes to the rules reflect LSC's obligation to safeguard public funds appropriated by Congress for civil legal aid by ensuring compliance with LSC rules, restrictions, and requirements. These additions to the enforcement mechanisms are consistent with Congressional intent to increase the flexibility in LSC's enforcement mechanisms in 1996 while carefully accounting for the need for continued delivery of legal services and the rights of LSC recipients.

COMMENTS SUBMITTED

In response to the FNPRM published on August 8, 2012, LSC received comments from the following entities:

- The LSC Office of Inspector General (OIG),
- American Bar Association Standing Committee on Legal Aid and Indigent Defendants (SCLAID),
- National Legal Aid & Defender Association (NLADA),
- New York State Bar Association Committee on Legal Aid (CoLA),
- Legal Services Association of Michigan (thirteen legal aid programs),
- Midwest Project Directors Group (twenty-one legal aid programs),
- All six LSC recipients in New York State outside of New York City, and
- Northwest Justice Project (NJP) (Washington State).

None of the comments opposed the FNPRM changes to the original proposed rules. Generally, the comments supported the changes as improvements, but many still opposed the rulemaking and/or recommended more changes. The OIG supported the FNPRM, subject to their prior comments on the Notice of Proposed Rulemaking (NPRM). The other six comments proposed adding more standards and procedures, many of which would increase the existing standards and procedures for terminations and suspensions. SCLAID continued to support the goal of the rulemaking, subject to suggestions for increased standards and procedures. NLADA and other commenters opposed the rulemaking, and, in the alternative, strongly recommended increasing the standards and procedures established in these rules in 1998. Many comments provided technical suggestions that Management will incorporate in the draft final rule. The comments of CoLA, Legal Services Association of Michigan, and the Midwest Project Directors Group all endorsed NLADA's comments, and the six New York State recipients and NJP provided comments that were similar to some of NLADA's comments; they are not separately addressed in this memo. NJP also provided some unique comments. This memo addresses each major issue raised.

STATUTORY AND REGULATORY BACKGROUND

Prior to 1996, section 1011 of the LSC Act provided minimum requirements for suspensions, terminations, and denials of refunding. In 1996, Congress suspended section 1011 via riders to the annual LSC appropriation, which have been reincorporated every year thereafter, including some modifications in 1998. Section 1011 is relevant to provide the context for those statutory changes and the subsequent changes to the LSC enforcement regulations.

Sect. 1011. The Corporation shall prescribe procedures to insure that—

(1) financial assistance under this title shall not be *suspended* unless the grantee, contractor, or person or entity receiving financial assistance under this title has been given *reasonable notice and opportunity to show cause* why such action should not be taken, and

(2) financial assistance under this title shall not be *terminated, an application for refunding shall not be denied, and a suspension of financial assistance shall not be continued for longer than thirty days*, unless the grantee, contractor, or person or entity receiving financial assistance under this title has been afforded *reasonable notice and opportunity for a timely, full, and fair hearing*, and, *when requested*, such hearing shall be conducted by an *independent hearing examiner*. Such hearing shall be held *prior to any final decision* by the Corporation to *terminate* financial assistance or *suspend or deny funding*. Hearing examiners shall be appointed by the Corporation in accordance with procedures established in regulations promulgated by the Corporation.

42 U.S.C. § 2996j (emphasis added). Section 1007(a)(9) of the LSC Act further provided that LSC shall provide interim funding for any entity with a pending application for refunding until the application is either approved or denied pursuant to section 1011. 42 U.S.C. § 2996f(a)(9).

LSC implemented these statutory requirements in 1976 and 1978 through the original enforcement regulations: Part 1618 (General enforcement thresholds), Part 1606 (Terminations and denials of refunding), and Part 1623 (Suspensions). Part 1606 provided a right to a hearing before an independent hearing examiner who was not an LSC employee. 45 C.F.R. § 1606.8(a), as published in 43 Fed. Reg. 32,769, 32,770 (1978). Subsequently, in 1983, LSC removed denials of refunding from Part 1606 and created Part 1625 as a separate regulation on that topic. 48 Fed. Reg. 54,196 (1983).

From 1978 through 1998, Part 1606 permitted terminations based on “substantial failure by a recipient to comply with a provision of law, or a rule, regulation, or guideline issued by the Corporation, or a term or condition of a current or prior grant from or contract with the Corporation.” *Id.* (language of 45 C.F.R. § 1606.3 in effect prior to the 1998 revisions). Part 1606 did not contain further guidance regarding what constituted a “substantial failure,” but it also required that, “[i]n the absence of unusual circumstances, a grant or contract shall not be terminated for this cause unless the Corporation has given the recipient notice of such failure and an opportunity to take effective corrective action” *Id.* These standards applied to terminations of any amount. Part 1623 provided the same language regarding suspensions. 45 C.F.R. § 1623.3(c), as published in 43 Fed. Reg. 21,883 (1978). During that time, LSC could not deny refunding without similar procedures, but the regulations allowed LSC to reduce an award at renewal by up to ten percent as a discretionary matter. 45 C.F.R. Part 1606, as published in 43 Fed. Reg. 32,769 (1978); and Part 1625, as published in 48 Fed. Reg. 54,196 (1983).

Part 1623, regarding suspensions, was drafted in 1978 to include an informal conference, which met the notice and opportunity to be heard requirement of the LSC Act, but it limited

suspensions to thirty days. Those provisions of Part 1623 are still in effect, even though Congress lifted the enforcement process requirements of the LSC Act in 1996. If the regulation had provided for suspensions lasting longer than thirty days, then, prior to 1996, the full advance hearing rights of the Act would have applied for those suspensions of over thirty days.

Beginning in FY 1996, Congressional appropriations for LSC have suspended these provisions of the LSC Act.

For the purposes of the funding provided in this [FY 1996 Appropriations] Act, rights under sections 1007(a)(9) and 1011 of the Legal Services Corporation Act (42 U.S.C. 2996f(a)(9) and 42 U.S.C. 2996j) shall not apply.

Pub. L. 104-134, § 503(f), 110 Stat. 1321 (1996) (FY 1996); Pub. L. 104-208, § 501(b), 110 Stat. 3009 (1996) (FY 1997) (reiterating the FY 1996 language). For FY 1998, Congress reiterated the FY 1996 language and further elaborated that LSC “may terminate” a grant or contract if LSC finds “that the recipient has failed to comply with any requirement of the Legal Services Corporation Act (42 U.S.C. 2996 et seq.), this [appropriations] Act, or any other applicable law relating to funding for the Corporation” Pub. L. 105-119, §§ 501(b) and (c), 111 Stat. 2440 (1997) (FY 1998). Congress has incorporated that language by reference in every annual LSC appropriation since 1998. Congress also mandated in 1996 and thereafter that LSC have the option to suspend funding to a recipient, in full or in part, if the recipient fails to have an acceptable audit. Audit-based suspensions last until completion of an acceptable audit. Pub. L. 104-134, § 509(c), 110 Stat. 1321 (1996) (FY 1996) (incorporated by reference thereafter). Lastly, beginning in 1996, Congress has mandated that LSC award basic field grants using a competitive process and eliminated the statutory refunding rights. Pub. L. 104-134, § 503(a), 110 Stat. 1321 (1996) (FY 1996) (incorporated by reference thereafter).

LSC implemented these statutory changes by eliminating Part 1625 regarding refunding and revising Parts 1606 and 1623. 63 Fed. Reg. 64,636 (1998) (Parts 1606 and 1625), 63 Fed. Reg. 64,646 (1998) (Part 1623). LSC explained that:

the new law in the appropriations act emphasizes a congressional intent to strengthen the ability of the Corporation to ensure that recipients are in full compliance with the LSC Act and regulations and other applicable law. *See* H. Rep. No. 207, 105th. Cong., 1st Sess. 140 (1997). Accordingly, under this rule, the hearing procedures in part 1606 have been streamlined. The changes are intended to emphasize the seriousness with which the Corporation takes its obligation to ensure that recipients comply with the terms of their grants and provide quality legal assistance. At the same time, the Corporation intends that recipients be provided notice and a fair opportunity to be heard before any termination or debarment action is taken.

63 Fed. Reg. at 64,637 (preamble to revised Parts 1606 and 1625). LSC further elaborated in the preamble to the rulemaking that:

[t]he legislative intent underlying Sections 501(b) and (c) of the Corporation's FY 1998 appropriations act was to enable the Corporation to streamline its due process procedures in order to ensure that recipients are in full compliance with LSC grant requirements and restrictions.

Id. at 64,640. LSC carefully balanced the concerns for ongoing client services and recipient rights with the clear direction from Congress to enhance accountability and oversight of recipients' use of LSC funds. The current rulemaking is designed to build upon, but not fundamentally alter, the rationale for the 1998 rulemaking.

In both Parts 1606 (terminations) and 1623 (suspensions), the 1998 rulemaking added the current five factors for consideration in determining whether a "substantial violation" had occurred:

A determination of whether there has been a substantial violation for the purposes of paragraph (a)(1) of this section will be based on consideration of the following criteria:

- (1) The *number of restrictions* or requirements violated;
- (2) Whether the violation represents an instance of noncompliance with a *substantive statutory or regulatory restriction* or requirement, rather than an instance of noncompliance with a non-substantive technical or procedural requirement;
- (3) The extent to which the violation is part of a *pattern of noncompliance* with LSC requirements or restrictions;
- (4) The extent to which the recipient *failed to take action to cure* the violation when it became aware of the violation; and
- (5) Whether the violation was *knowing and willful*.

45 C.F.R. §§ 1606.2(b) and 1623.2(a) (emphasis added). LSC defined "knowing and willful" to mean that:

the recipient had *actual knowledge* of the fact that its action or lack thereof *constituted a violation* and[,] despite such knowledge, undertook or failed to undertake the action.

45 C.F.R. §§ 1606.3(b) and 1623.3(b) (emphasis added).

LSC replaced the "opportunity to cure" requirement with the fourth factor because LSC determined that to "provide an opportunity to cure in all instances would slow down the process and tie the Corporation's hands when there is a need to act more quickly." 63 Fed. Reg. at 64,640 (preamble to final Part 1606). Furthermore, LSC stated that a "recipient that has

substantially violated the terms of its grant is not entitled to a second chance as a matter of right.” *Id.*

LSC replaced the non-LSC independent hearing examiner requirement with an impartial hearing officer, who could be an LSC employee. 45 C.F.R. § 1606.8.

LSC also created a new category for reductions of a current grant by less than five percent. 45 C.F.R. § 1606.2(d)(2)(v). LSC could not impose those limited reductions until LSC adopted regulations to do so, which the Board has not yet done; the necessary regulations are the subject of this rulemaking. *Id.* See 63 Fed. Reg. 64,636 (1998) (preamble to revised Parts 1606 and 1625), 63 Fed. Reg. 64,646 (1998) (preamble to revised Part 1623).

Lastly, LSC retained the thirty-day limit on suspensions because a “suspension is intended to be used for extraordinary circumstances when prompt intervention is likely to bring about immediate corrective action.” 63 Fed. Reg. at 64,648. LSC determined that if suspension were insufficient to address the problem, then LSC should “initiate a [Part 1606] termination process” *Id.*

ANALYSIS OF COMMENTS

Management agrees with many of the comments received in response to the FNPRM that improve the structure and operation of the proposed rules. Management disagrees with the comments that would fundamentally alter the standards and procedures as they were adopted in 1998. Except for the OIG, the comments all recommend *raising* the standard for a finding of non-compliance and some reinstatement of the pre-1998 independent hearing examiner requirement. The discussion below addresses the major issues raised in the comments.

Suspensions—Final Decisions and Appeals

The FNPRM continued the NPRM proposal to extend the maximum duration of a suspension of funding to ninety days. In its comments, the OIG maintained its position that suspensions should continue indefinitely until the recipient returns to compliance. Management continues to recommend a ninety-day limit for suspensions of funding. The purpose of extending the suspension to ninety days is to improve the effectiveness of suspensions without permitting suspensions to become *de facto* terminations or lesser reductions of funding without the due process procedures of Part 1606. During the suspension, LSC can begin limited reduction or termination proceedings, if necessary. Once a recipient has demonstrated an unwillingness or inability to comply within ninety days, Management believes that a permanent reduction in funding for the duration of the grant award term is more appropriate than a continued suspension of funding beyond ninety days. Although the suspended funding would be restored after ninety days, Management considers the ability of LSC to impose more permanent enforcement actions and special grant terms a meaningful way to address the OIG concerns about recipient accountability and preventing non-compliant recipients from continuing to use LSC funds for unauthorized or prohibited purposes.

SCLAID also proposed adding appeals to the LSC President prior to any suspensions and, for those appeals, using a process that is similar to the proposed limited reduction in funding appeals. In cases in which the President is precluded from hearing the appeal because the President had prior involvement in the suspension, SCLAID proposed appointment of a non-LSC independent hearing examiner to hear the appeal.

In a related comment on impartiality in suspension decisions, NLADA proposed requiring that a senior LSC employee make suspension decisions, as is the case for limited reductions of funding in the FNPRM. NLADA recommended using the full pre-1998, Part 1606-termination, prior-appeal process involving a hearing before a non-LSC independent hearing examiner for suspensions of funding in amounts over \$10,000. NJP recommended excluding deputy directors from the list of decision makers for suspensions, terminations, debarments, and limited reductions.

Management agrees with the comments that some type of an appeal is appropriate for suspensions. Management disagrees, however, with the proposals to return to the pre-1996 requirements of the LSC Act for advance hearings before independent hearing examiners for suspensions of more than thirty days. Management also disagrees with the proposal for creating a \$10,000 threshold and advance appeals. Rather, Management proposes the following changes regarding Part 1623:

- adding the same senior-employee decision maker definition for suspensions as LSC previously proposed for limited reductions and terminations;
- specifying that a deputy director can make those decisions only if the deputy is acting in the capacity of a director due to a vacancy or significant absence;
- continuing, without change, the existing, longstanding rules for suspensions of thirty days or less, in which a suspension can be imposed after an informal conference with LSC; and
- adding an appeal process for suspensions lasting over thirty days that would provide for immediate review by the LSC President, who would not have been involved in the initial suspension decision (as is the case for the proposed limited reductions of funding). The LSC President could also appoint another senior LSC employee to make the decision, at his or her discretion. This process would be based on the existing Part 1630 disallowed cost appeal process. The suspension would continue during the appeal, which would be subject to deadlines to ensure that the appeal is promptly resolved.

The history of the suspension regulation provides important context for appeals. Part 1623 provides that the purpose of the suspension rule is to:

- (a) Ensure that the Corporation is able to take *prompt action* when necessary to safeguard LSC funds or to ensure the compliance of a recipient with applicable provisions of law, or a rule, regulation, guideline or instruction issued by the

Corporation, or the terms and conditions of a recipient's grant or contract with the Corporation; and

(b) Provide procedures for *prompt review* that will ensure informed deliberation by the Corporation when it has made a proposed determination that financial assistance to a recipient should be suspended.

45 C.F.R. § 1623.1 (emphasis added). The regulation then provides for immediate suspensions of up to thirty days subject to an advance informal conference, which meets the pre-1996 statutory requirement for notice and an opportunity to be heard. 45 C.F.R. § 1623.4; *see* 43 Fed. Reg 21,883 (1978) (original Part 1623).

As discussed above, in 1996 Congress lifted the suspension-related procedural provisions of the LSC Act. In 1998, Congress further provided that *terminations* could occur “after notice and opportunity for the recipient to be heard,” but Congress was silent regarding new *suspension* requirements. Nonetheless, LSC has maintained the requirement of notice and an opportunity to be heard for all suspensions. LSC revised Part 1623 to include audit-based suspensions, without a time limit, and without any other appeal rights, but did not choose to expand other suspensions beyond thirty days. At the time, LSC determined that it should “initiate a termination process” if a suspension of thirty days was inadequate. 63 Fed. Reg. at 64,648 (preamble to revised Part 1623). Management is now recommending suspensions of up to ninety days to better correspond to the timeframes of the other enforcement options.

Standard for Terminations

Knowing and Willful

All of the commenters other than the OIG recommended a significant overhaul of the substantive standard for terminations, suspensions, and the proposed limited reductions. They recommend converting the *consideration* of whether a violation was “knowing and willful” to a *requirement* that the violation have been knowing and willful. They also recommend including a safe harbor for good faith reliance on a reasonable interpretation of the requirements. Management does not agree with these recommendations, because adopting them would significantly increase these standards beyond what LSC has had in place for over thirty-four years. LSC developed the current, detailed list of factors for consideration in 1998 when LSC updated these rules in response to statutory changes. At that time, Congress had lowered the requirements for terminations of funding. The then-existing rules did not have a mandatory intent factor, and neither did the rules as revised in 1998. Adding one now would run contrary to the intent of the 1998 statutory and regulatory changes. The OIG also opposes changing these standards for similar reasons discussed in their comments to the FNPRM.

LSC commenced this rulemaking to fill in the gap created in 1998 when LSC created a “non-termination” category for reductions in funding of less than five percent. Both the NPRM and the FNPRM use *the existing standard for suspensions and terminations* as the standard for limited reductions. As discussed above, the existing standard was carefully developed by LSC in

1998 in response to statutory changes to the LSC Act's provisions regarding suspensions, terminations, and refunding. Management does not recommend changing those standards.

Part 1618 requires that enforcement actions meet one of three criteria, two of which include a standard with intent. Only "persistent" violations can be acted on without a required showing of intent; even then, LSC must consider the five criteria for a substantial violation in Part 1606, two of which involve intent. Before taking enforcement action, LSC must determine that there is a "substantial reason to believe" that:

- 1) the recipient has "persistently . . . violated" the LSC requirements, *or*
- 2) the recipient has "intentionally violated" the LSC requirements, *or*
- 3) "after notice, [the recipient] has failed to take appropriate remedial or disciplinary action to insure [sic] compliance by its employees with the Act, and attempts at informal resolution have been unsuccessful"

45 C.F.R. § 1618.5(b). The third option includes an intentional element, because the recipient is acting intentionally if LSC has notified it that the actions in question are violations and the recipient does not take appropriate actions to ensure compliance. Thus, only persistent violations meet the Part 1618 threshold without any showing of intent to violate LSC requirements.

If LSC were to proceed to a termination or limited reduction for a persistent violation without a showing of intent, then LSC must still consider the five factors in Part 1606 before finding that a substantial violation has occurred. Two of those factors themselves include intent. The fourth factor is "[w]hether the violation was knowing and willful," which is defined as "actual knowledge of the fact that its action or lack thereof constituted a violation and[,] despite such knowledge, undertook or failed to undertake the action." 45 C.F.R. §§ 1606.3(2)(d) and 1606.2(b), respectively. The fifth factor is the "extent to which the recipient failed to take action to cure the violation when it became aware of the violation" *Id.* That factor contains an intent element, because it requires LSC to consider what the recipient did after learning that a past action in fact violated the LSC requirements.

In 1998, when LSC revised the Part 1606 standards, the combination of Part 1618 and the new Part 1606 factors provided a framework for determining whether to terminate all or part of a recipient's funding. That approach balanced the concerns for ongoing client services and recipient rights with the clear direction from Congress to enhance accountability and oversight of recipients' use of LSC funds. None of the comments has indicated that circumstances have changed since 1998, nor that there is any reason to apply a higher standard for limited reductions of funding of less than five percent than currently applies to terminations of five percent or greater.

NLADA also recommended changing the existing "persistently or intentionally" threshold in Part 1618 (unchanged in the FNPRM) to a "knowing and willful" threshold using the definition in Part 1606. Doing so would eliminate the possibility of taking enforcement actions based on persistent, but not intentional, violations. Management disagrees with eliminating "persistently" as a separate avenue for enforcement. As discussed above, LSC has

had the ability to take action on this basis since 1978. Part 1618 merely provides a threshold for LSC to proceed to consider an enforcement action. Thereafter, under either Part 1606 or Part 1623, LSC must consider the five criteria for determining if a substantial violation has occurred. As discussed above, two of those criteria include intent. The remaining three factors involve (1) the “number of restrictions or requirements violated,” (2) whether they are substantive or technical requirements, and (3) whether there is a “pattern of noncompliance.” 45 C.F.R. §§ 1606.3(2)(d) and 1606.2(b), respectively. Thus, the rules already provide for a thorough inquiry into the nature of any violations meeting the Part 1618 thresholds in order to determine if they constitute “substantial violations.”

Good Faith Safe Harbor

All of the commenters other than the OIG recommend adding a requirement in Parts 1606 and 1623 that LSC could not impose a termination, limited reduction, or suspension if the recipient has relied in good faith on a reasonable interpretation of state or federal law as a basis for its action or failure to act. SCLAID specifically states that if LSC disagrees with a “reasonable interpretation of state law, ethical requirements[,] or other authority” then “the matter should be taken to an appropriate external and impartial tribunal.” Management disagrees with this recommendation because, as discussed above, LSC has already adopted the standards for terminations and suspensions, and there is no indication that they are insufficient and need revision. In the 1998 revisions, LSC eliminated the requirement that, in most situations, LSC first provide the recipient with an opportunity to correct the violation. Instead, LSC added consideration of the recipient’s remedial actions as part of the Part 1606 inquiry. LSC needs to retain the discretion to enforce the LSC requirements as LSC interprets them. The existing standards provide opportunities for a recipient to raise good faith reliance on other reasonable interpretations. Furthermore, the proposed language could unnecessarily complicate enforcement actions through collateral disputes over whether or not alternative interpretations were “reasonable.” LSC has the statutory responsibility and authority to interpret and apply its own requirements.

Whether the recipient acted in good faith reliance on a reasonable interpretation of the rules is a necessary component to the Part 1618 “intentionally violated” language and the “knowing and willful” factor in Parts 1606 and 1623. The definition of “knowing and willful” requires “actual knowledge of the fact that its action or lack thereof constituted a violation” 45 C.F.R. § 1606.2(b). In any termination, suspension, or lesser reduction proceeding, the recipient will have an opportunity to raise good faith reliance on a reasonable alternate interpretation of the requirements. The current standards permit LSC to evaluate that argument in the context of all of the factors for consideration. Adding it as a determinative factor would unnecessarily constrain LSC’s discretion to look at the entire situation to determine whether a substantial compliance failure has occurred and what enforcement action to take.

The LSC statutes and regulations have never provided this type of absolute defense. Rather, prior to 1998, Parts 1606 and 1623 provided that, except for unusual circumstances, LSC could not impose a suspension or termination until the recipient had notice of, and an opportunity to cure, the violation. Effectively, this prevented LSC from taking immediate remedial action regardless of whether the recipient had a good faith reason for its actions. After notice, the

recipient had to comply with the requirements, as interpreted by LSC, or risk suspension or termination. At that point the recipient could not rely on any other interpretations of the rules.

In 1998, LSC converted this requirement into the fifth factor for consideration in Parts 1606 and 1623 regarding the “extent to which the recipient failed to take action to cure the violation when it became aware of the violation . . .” 45 C.F.R. § 1606.3(2)(d). LSC eliminated the pre-1998 presumption against taking remedial actions without an opportunity to cure. LSC determined that Congress intended LSC to streamline its compliance procedures, and LSC explained that to “provide an opportunity to cure in all instances would slow down the process and tie the Corporation’s hands when there is a need to act more quickly.” 63 Fed. Reg. at 64,640 (preamble to final Part 1606). LSC noted when adopting the revised rule that corrective actions were one of the factors for consideration in determining whether a substantial violation took place. *Id.* Similarly, good faith reliance on reasonable interpretations of the requirements is a part of the consideration of the knowing and willful factor, discussed above, but making it an absolute requirement would run contrary to the direction of the 1998 revisions to the rule.

Furthermore, adoption of this good faith test as an absolute requirement would significantly alter the dynamic for terminations, suspensions, and limited reductions. Recipients would have an incentive to withhold compliance questions in order to preserve their good faith defense. LSC prefers to encourage recipients to ask compliance questions in advance and avoid compliance problems. LSC needs to have the authority to apply the rules as it interprets them, and to encourage recipients to seek clarification of the rules whenever possible.

Amount of Funds Misused

SCLAID’s comments to the FNPRM proposed adding a new factor to the requirements for terminations, limited reductions, and suspensions for consideration of “the amount of funding that was inappropriately used.” Management opposes this recommendation for two reasons. First, as discussed above, this new factor would alter the standards set out in these regulations in 1998. There has been no showing that the current standards are insufficient. Second, the amount of funds involved in a violation may have no bearing on the significance of the violation, unlike the existing five factors. For example, in one situation, LSC found that executive director of a recipient knowingly violated the lobbying restrictions. Very few LSC funds were spent on that work, and so the disallowed costs were very limited notwithstanding the egregiousness of the situation. Adding this as a factor might dilute, rather than enhance, the substantive violation analysis.

Separate Standards for the Magnitude of the Enforcement Action

None of the enforcement rules has ever provided a separate inquiry regarding how to determine the scope of the suspension, termination, or limited reduction. Rather, the rules leave that determination to the administrative discretion of LSC after determination of whether a substantial violation has occurred. SCLAID’s comments to the FNPRM proposed adding a separate procedural stage regarding magnitude with a new, separate set of factors. Those factors would include the four factors in the current rule (excluding the fifth factor for “knowing and willful” because SCLAID would promote it to a threshold factor). SCLAID would add the factor

regarding the amount of funding misused, mentioned above, and another three factors regarding the availability of other funds and the impact of the reduction in funding on the recipient and on client services. Similarly, SCLAID proposed adding a new section to Part 1623 for consideration of nine factors regarding the length of a suspension. Those factors would be similar to the ones proposed for Part 1606.

Management opposes this suggestion for two reasons. First, as with the proposed changes to the standards, discussed above, this suggestion would add a new stage and set of factors to the longstanding regulatory structure. There has been no showing that the current rules are insufficient in this area. Second, adding an impact analysis would unnecessarily complicate the rules in a way that could dilute the emphasis on ensuring compliance. LSC has never included impact as a specific factor for consideration when taking enforcement actions. LSC always retains discretion to consider the impact on client services and recipients as part of its general grants oversight, as a matter of administrative discretion. Nonetheless, enforcement actions are fundamentally about ensuring compliance with the LSC requirements. In almost every case, any reduction of funding will have significant effects on clients and the operations of the recipient. The measure of an enforcement action should relate directly to the magnitude of the violation and deterrence of future violations. LSC's oversight obligations are not vitiated by the impact of enforcement actions, although LSC has the discretion to consider impact in structuring an enforcement action to accomplish its goal of creating an environment for effective compliance while minimizing disruption of client services.

Independent Hearing Examiners and Appeals

All of the commenters other than the OIG and SCLAID recommended changing the current Part 1606 rule to return to the pre-1996 requirement to have non-LSC independent hearing examiners for termination hearings. Those commenters also proposed applying the full termination procedures, including the independent hearing examiners, to limited reductions of funding over \$10,000 and to all proposed suspensions. Management disagrees with these recommendations. As discussed above, in 1998, Congress clearly changed the statutory structure to eliminate the independent hearing examiner requirement and LSC determined that it was not necessary in Part 1606. LSC carefully considered this issue in 1998 and concluded that providing for an impartial hearing officer, who could be employed at LSC, was sufficient to address recipient's rights in the context of the statutory language. 63 Fed. Reg. at 64,641 (preamble to revised Part 1606). Management sees no reason to revisit that decision at this time, nor to add that as a requirement for the new limited reductions.

For limited reductions of funding, the FNPRM proposed using the Part 1630 appeal procedure in which the appeal is heard by the LSC President or another senior LSC employee not involved in the initial decision. SCLAID and NJP questioned if the LSC President would overrule a staff decision and whether a senior LSC employee other than the President would overrule a decision in which the President had been involved. SCLAID proposed appeals to an independent hearing examiner if the President had been involved in the initial decision. NJP recommended prohibiting involvement by the President prior to the appeal. Management agrees with the concerns raised but disagrees regarding how to address them. As discussed above, involvement of an independent hearing examiner would move enforcement mechanisms in the

opposite direction of the earlier statutory changes. Instead, Management recommends emphasizing that the LSC President should not be involved in the initial decisions for enforcement actions. The regulations can preserve the option of appointing another senior LSC employee if necessary. The purpose of the appeal is to create an opportunity for a fresh look at the situation. Management believes that this process, modeled on the longstanding Part 1630 appeal process, provides the best balance of administrative burdens of the process against procedural fairness concerns for limited reductions of funding of less than five percent.

Publication of Final Decisions

The OIG recommended a publication requirement for final decisions regarding terminations, debarments, or limited reductions. The OIG noted that publication would provide transparency that may address some of the concerns regarding arbitrary actions by LSC in the absence of review by an independent hearing examiner. Management agrees with this recommendation. Those decisions are already subject to FOIA.

Need for New Enforcement Mechanisms

NLADA, and the four comments that endorsed NLADA's comments, continued to oppose the rulemaking entirely. NLADA reiterated its reasons why the rulemaking should not proceed: 1) a lack of actual need, 2) sufficiency of existing tools, 3) harm to clients and potential clients, 4) lack of due process, 5) insufficient standards, and 6) no recommendation for new enforcement tools by the GAO or LSC's Fiscal Oversight Task Force. Management has found that existing tools are insufficient to address the types of situations in which non-compliance becomes a significant concern, but does not call for termination. Limited reductions of funding, longer suspensions, and immediate special grant conditions will provide LSC with the additional enforcement options to address these compliance problems and to encourage better, and more timely, implementation of corrective actions.

Immediate Special Grant Conditions

None of the comments addressed the proposed immediate special grant conditions.

CONCLUSION

As with the original proposed rules, all of the comments except for those of the OIG recommend substantial changes to the overall regulatory structure for all enforcement actions. Management agrees with a number of modifications to improve the proposed rules within the structure of the existing rules. Management disagrees with the recommendations for revisiting the existing enforcement regulations regarding terminations and suspensions to adopt higher standards. Management continues to recommend limited rulemaking to provide for limited reductions of funding, suspensions of up to ninety days, and immediate special grant conditions.