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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: Enforcement Mechanisms—Analysis and Examples

Date: September 18, 2012

INTRODUCTION

The Operations and Regulations Committee (Committee) is considering adoption of three additional enforcement mechanisms: 1) lesser reductions in funding (under five percent), 2) suspension of funding for up to ninety days, and 3) immediate special grant conditions. On August 8, 2012, LSC published a Further Notice of Proposed Rulemaking (FNPRM) with revised proposed rules. Comments have been submitted, and LSC Management (Management) will discuss them at the Committee's meeting on September 30.

Management and the LSC Office of Inspector General (OIG) have recommended adoption of these additional enforcement mechanisms based on their experience with oversight of LSC recipients. LSC's current enforcement tools have two gaps in coverage: 1) a substantive gap for reductions in funding between zero and five percent, and 2) a procedural gap between thirty-day suspensions with an eleven-day process and full or partial terminations with a six-month process. Although significant compliance problems arise infrequently, LSC needs appropriate tools to respond when they do. Having such tools would provide options with immediate financial consequences that are proportionate to the compliance problems, and that would be appropriate in situations that do not merit full or partial terminations or the corresponding lengthy and resource-intensive process. They may also have the deterrent effect of further encouraging recipients to take proactive steps to prevent significant non-compliance. Additionally, these enforcement tools could help prevent or address situations involving significant delays for implementing corrective actions.

Any financial consequences for a recipient are likely to affect both client services and dedicated legal aid staff. The best oversight provides the right balance of incentives and consequences to encourage recipients to avoid significant non-compliance, and thus avoid disruptions in LSC funding. Unfortunately, as experience has shown, significant problems can occur. In some cases, LSC's current tools are just right. In others, LSC has faced the difficulty of adapting tools that may be too weak or too extreme for the situation. Also, the termination tools may involve a larger diversion of LSC and recipient resources to the process than the situation merits. Some significant problems are not well addressed with resource-intensive tools designed for larger problems. Furthermore, LSC's ability to respond effectively and appropriately to compliance concerns is vital to the credibility of, and support for, the federally-funded legal aid system.

This memo will first discuss these gaps in LSC's enforcement tools. Then it will identify situations of significant non-compliance over the past few years. Using those examples, the memo will address the shortcomings of the current system and discuss how the proposed additional enforcement mechanisms would improve it.

At the July meeting, the Committee requested timelines for the existing and proposed enforcement mechanisms. Attached are individual timelines and a comparison of timelines for Part 1623 suspensions, Part 1606 proposed limited reductions, and Part 1606 terminations. For reference, the timelines include Part 1630 disallowed costs, which are not designed as an enforcement mechanism, but carry financial consequences that can have a deterrent effect.

CURRENT ENFORCEMENT TOOLS

The Part 1606 termination regulation does not apply to reductions of less than five percent of LSC funding, and it prohibits LSC from imposing limited reductions until LSC adopts regulations for the process. Although Part 1606 was last revised in 1998, LSC has not developed limited reductions regulations to close this gap. For terminations of between five percent and one-hundred percent, the procedural protections of Part 1606 apply, including a right to a hearing before an impartial hearing officer. The full Part 1606 process would take approximately 175 days, almost six months, as shown in the attached timelines. These timelines begin with the decision to take action, which is likely to occur after weeks, or possibly months, of LSC investigation. Thus, a full termination might not occur until almost nine months, or more, after LSC begins to investigate a matter. Furthermore, the multistage Part 1606 process requires a significant devotion of resources by LSC to pursue the matter and diverts similar resources from the recipient for responding to it.

Part 1623 suspensions are designed to compel a recipient to take immediate corrective action when it might not do so otherwise. The rule limits non-audit suspensions to thirty days, and has done so since inception in 1978. At that time, LSC provided a larger and more critical portion of most recipients' funding. Part 1623 was revised in 1998, but the thirty-day limit was retained based on the expectation that compliance concerns should be resolved in thirty days, otherwise LSC should "initiate a [Part 1606] termination process." 63 Fed. Reg. 65648 (Nov. 23, 1998) (preamble to the final rule). LSC can commence suspensions quickly, within eleven days, but the suspended funds must be released thirty days later. In less than two months, even with no implementation of corrective actions, the suspension would have completely run its course. The recipient would continue with full funding while LSC pursues the six-month termination process. These rules leave a four-month procedural gap in the enforcement system.

Furthermore, the effectiveness of a thirty-day suspension ranges greatly with the situation. Some recipients still depend heavily on LSC funding. For these recipients, the thirty-day suspension, or threat thereof, may be sufficient. Others have substantial non-LSC funding and may carry fund balances. Additionally, for most of the year, LSC recipients have an advance of a full month of LSC funding. Thus, many recipients may have sufficient resources to carry them through a thirty-day suspension until LSC must release the funds.

Corrective actions may require changes to practices and procedures that cannot, or will not, be completed within thirty days. As discussed in the examples provided below, some recipients have unnecessarily taken two years to implement corrective actions. LSC could, foreseeably, impose a suspension to encourage the recipient to implement corrective actions promptly. However, under the current rule, that suspension would expire in thirty days, even if the corrective actions were still pending. The next step would be a termination, which, as discussed above, takes almost six months to implement. That gap between the two rules undermines LSC's enforcement credibility, especially when the funds would be released to the recipient despite the continued failure to comply.

LSC's leverage using suspensions depends on the amount and the possible duration of the suspension. Under the proposed rule, full or partial suspensions could continue for up to ninety days. The longer time limit would provide LSC more flexibility to calibrate the amount of the suspension to the situation. In some cases, a partial suspension for up to ninety days may be more effective, and less disruptive to client services, than a full suspension of up to thirty days.

Competition provides an opportunity for LSC to end funding to a recipient without Part 1606 termination procedures. Nonetheless, it is not designed, or easily used, as an enforcement tool. Competition occurs over a six-month period, typically, in cycles of one, two, or three years, depending on the grant term awarded in the last cycle. Thus, the scheduled competition may not coincide with the discovery of a problem. Alternately, the service area could be in competition, but LSC does not have a viable alternative to the incumbent. Usually, only the current recipient applies for a service area. While competition may provide an effective way of replacing a recipient in some situations, but it does not provide a quick, targeted method for addressing compliance concerns.

Limited funding terms (monthly, quarterly, etc.) and the imposition of special grant conditions are techniques to persuade recipients to implement corrective actions and to improve the quality of services to eligible clients. LSC can impose these as part of an award during competition or during annual renewal. They rely on the threat of LSC taking enforcement actions or terminating funding after the limited term expires. As such, these tools are subject to the same limitations discussed above.

Disallowed costs under Part 1630 are LSC's only other option with financial consequences. Part 1630 enables LSC to recover funds that were improperly spent or misallocated. The amount of funds subject to disallowance is not related to the nature of the violation or the culpability of the recipient. Rather, disallowed costs are based on the amount of misspent funds. Thus, a willful violation of a major restriction might involve only a small amount of funds, while an accidental violation of a minor or procedural requirement might implicate a much larger sum. LSC can reduce a disallowed cost, as an equitable matter, when the recipient had acted in good faith, but LSC cannot increase a minor disallowed cost based on egregious behavior. Thus, a recipient could engage in a major, intentional violation of substantive restrictions, but not incur significant disallowed costs.

EXAMPLES OF SUBSTANTIVE NON-COMPLIANCE AND ANALYSIS OF CURRENT AND PROPOSED ENFORCEMENT TOOLS

The following situations have occurred involving substantive non-compliance by LSC recipients. This is not an exhaustive list, and it does not reflect what LSC has seen as the usual behavior of the overwhelming majority of LSC recipients. Rather, it demonstrates that, even in this context, there have been significant problems.

Perhaps the most significant recent example involved a recipient at which the longstanding executive director and some senior staff engaged in multiple violations of substantive and procedural requirements, including ongoing outside practice of law in direct violation of LSC laws and regulations. 45 C.F.R. Part 1604. Furthermore, the recipient violated LSC requirements involving the purchase of real property, the leasing of cars, and the payment of personal expenses. The investigation revealed that these actions were not isolated instances or good-faith errors. After lengthy investigations, LSC faced the options of rehabilitating the recipient, or ending funding. By coincidence, that service area was in competition for a new term, but there were no other applicants. Immediately ending funding to the recipient would cause a devastating loss of client services. Furthermore, while the problems were significant and pervasive, they did not indicate that the recipient was not providing vital client services. Due to the coincidence of the timing of competition, LSC was able to reject the incumbent's application for the service area. Instead, LSC provided the incumbent with temporary, monthly funding subject to special grant conditions—effectively putting it on probation. Simultaneously, LSC re-competed the service area.

If pervasive compliance problems like this are revealed to LSC for the first time after competition, perhaps during the first year of a three-year grant, LSC would not have the option to switch to short-term funding. The only available enforcement actions with financial consequences would have been an anemic thirty-day suspension, or a termination that would probably take six months to impose. Disallowed costs may be available, but they are subject to the limitations discussed above, and the process can take five months or more to complete. Furthermore, as discussed above, during the many months between a suspension and a termination (partial or full) LSC would have no other means of directly safeguarding the funds themselves (such as suspension) or imposing limited financial consequences if the recipient did not immediately address the violations. This very real possibility highlighted for Management the importance of adopting alternative enforcement mechanisms.

The re-competition for that service area took six months, during which LSC kept a tight rein on the recipient thanks to the coincidence of timing regarding the competition cycle. Because the incumbent served one area of a state with multiple LSC service areas, there were other programs that practiced in the state and could consider expanding to cover that service area. During the re-competition, a neighboring program applied. Had these problems occurred in a statewide program, there would be no other LSC recipients with a practice in that state. Although non-LSC recipients can apply for service areas, they do not already have systems in place for LSC compliance and reporting. Furthermore, most non-LSC recipients provide LSC-restricted services and/or serve LSC-prohibited clients. Lastly, even in states with multiple service areas, only a few programs provide services in adjacent areas. Thus, the pool of potential alternative providers is very small.

Compliance problems with a statewide program arose with a different recipient that suffered from a pervasive failure to comply with a broad range of LSC requirements. The recipient functionally failed a CSR/CMS visit. OCE imposed over thirty required corrective actions touching on almost every one of LSC's compliance-related regulations. The recipient ignored the draft report for ten months and then failed to take any significant compliance steps in response to either the draft or the final report. Unlike the prior example, there were no other LSC recipients in the state. Nor were there any non-LSC legal aid programs equipped to compete for the service area. Termination of funding (through Part 1606 or competition) would have eliminated services for the entire client population. Eventually, that happened, after LSC staff spent months/years in time and resources trying to rehabilitate the program. The recipient collapsed and surrendered the grant. LSC engaged in a lengthy, resource-intensive, and difficult task of building up a new program to apply for the service area. Meanwhile, there were no LSC-funded client services in the state.

A few years prior to the OCE review, that same recipient failed to submit its audit. After four months of extensions, the recipient could not say when it would complete the audit. Unlike ordinary suspensions, audit-failure suspensions continue until submission of an acceptable audit. The OIG recommended, and LSC imposed, an indefinite suspension of twenty percent. Because the suspension would not expire in thirty days, Management and the OIG felt that twenty percent was sufficient. There was no danger that the recipient could just wait it out. Within two months of the first notice, the recipient provided the audit and LSC lifted the suspension.

That experience demonstrated the effectiveness of enforcement mechanisms with financial consequences that LSC can quickly implement. In contrast, the thirty corrective actions required by OCE could not be completed in thirty days. Imposing a thirty-day suspension, even of one-hundred percent of funding, would have been ineffective. A suspension of up to ninety days, involving perhaps twenty percent of funding, might have had more success. Similarly, a limited reduction in funding might have been an effective tool to compel compliance without endangering client services.

The first situation, involving Part 1604 violations, also highlighted for Management the limitations of using disallowed costs as a compliance tool. The outside practice of law, if done on non-work hours, might not trigger any disallowed costs. In that situation, the executive director also failed to maintain timekeeping records. That additional error enabled LSC to disallow a large amount of funds attributable to his salary for multiple years. However, had he been more careful with his timekeeping, LSC would have been faced with a blatant violation of the restrictions and no significant costs to disallow. That was the situation at another recipient.

The executive director of another recipient engaged in willful non-compliance by directly and knowingly violating the LSC lobbying restrictions. The staff of the recipient determined that it could not participate in a prohibited lobbying matter unless a legislator requested their comments in writing, which had not happened. The regulations prohibit recipients from soliciting such a letter. 45 C.F.R. § 1612.6(c). Nonetheless, the executive director proceeded to lobby on the matter himself. Furthermore, he asked a legislator to provide a letter requesting comments from the recipient and presented it as an unsolicited request. Very few LSC funds were spend on that work, so the disallowed costs were very limited and did not provide a meaningful penalty in light of the egregious behavior of the executive director.

That executive director resigned, but the situation also highlighted for Management the need for alternative enforcement tools. The executive director might have stayed, and the recipient board could have determined that rehabilitation was better than replacement. LSC would have wanted to impose an appropriate penalty and have reasonable assurances that this executive director would not engage in, or encourage, other violations. A funding reduction of less than five percent would have presented a reasonable penalty. Furthermore, it would provide LSC with a credible threat of real and relatively quick consequences in the future. The availability of both limited reductions and ninety-day suspensions would have provided better tools for that realistic possibility than Part 1606 terminations of over five percent.

Once LSC has determined that corrective actions are necessary, the recipient must implement those actions. Generally recipients do so in a timely manner, although there have been occasions in which the recipient did not do so. In two situations, recipients had major and significant problems with their financial systems involving cost allocations or expense accounting. These problems were pervasive, but they were easily remedied. Nonetheless, the recipients each took two years to implement solutions. Thirty-day suspensions were available, but, as discussed above, presented the danger that the recipient would not, or could not, comply within thirty days, after which the funds had to be released. The next step would be a six-month process to impose a termination of at least five percent. That option required a dedication of LSC resources that seemed unwarranted, and would have the counter-productive effect of diverting recipient resources from implementing the corrective actions. Eventually LSC cajoled the recipients into compliance. Better enforcement tools could have provided those recipients with incentives to act promptly, and they could have equipped LSC to act more swiftly and decisively if they did not.

CONCLUSION

LSC seeks to maximize compliance by LSC recipients while minimizing any related loss to permissible client services. Unfortunately, in some situations LSC recipients engage in substantial non-compliance and/or are recalcitrant about implementing corrective actions. Suspensions of up to ninety days and penalties of up to five percent would enable LSC to threaten and, if necessary, take actions that are proportionate to serious compliance issues. These options would greatly enhance the ability of LSC to credibly add§ress these situations, and to reserve the threat of Part 1606 terminations, with the correspondingly lengthy and resource intensive process, for those situations that truly merit it.