



# It's The Law

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## **Denying Or Discontinuing Financial Assistance Relationships On The Basis Of Responsibility Concerns: The Requirement For Due Process**

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### INTRODUCTION

It is the policy of the Department of Commerce to make awards to applicants and recipients who are competently managed, responsible, capable and committed to achieving the objectives of the awards they receive. Grants officers are sometimes faced with pre-award circumstances which raise concerns about an applicant's responsibility, including a lack of integrity, to carry out the objectives of a particular grant or cooperative agreement. For example, negative information may come to light from a Dun and Bradstreet report or during the name check process. An applicant may be the subject of negative findings in a draft or final audit, or may be the subject of negative information from ongoing inspection or investigation activities. In addition, there may be a record of poor prior performance on other awards, debt problems, or negative items reported by an applicant on Form CD-511 concerning debarment, suspension and other responsibility matters.

The purpose of this article is to ensure that grants officials are aware of the availability of the procedures for denying or discontinuing financial assistance relationships on the basis of responsibility concerns with grant applicants or current recipients (who are seeking renewals, continuations, or new awards) and to reinforce the need to follow those procedures.<sup>1</sup> Such procedures include:

High-risk determinations – Where an applicant is declared high-risk and is denied an award on the basis of concerns relating to the applicant's present responsibility, the applicant must be given notice of the Department's determination.

Suspension/debarment – In serious cases, usually indictment for and/or conviction of criminal offenses, the Department of Commerce provides

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<sup>1</sup> The termination of existing financial assistance awards is beyond the scope of this article and may be addressed in a future issue.

formal procedures for excluding an organization from participating in financial assistance on a government-wide basis. See 15 CFR Part 26, Non-procurement Debarment and Suspension.

Failure to follow the required procedures can result in an illegal *de facto* debarment for which an applicant can seek redress in a Federal district court.

## BACKGROUND

Financial assistance applicants have certain procedural rights if an agency proposes to deny an award on the basis of responsibility concerns on the part of the applicant. Specifically, the courts have found that applicants have a constitutionally protected “liberty interest” in doing business with the government that gives rise to a due process right under the Fifth Amendment of the Constitution to reasonable notice and an opportunity to be heard appropriate to the circumstances of the case.

It is clear that the definition of “liberty,” in the context of the Fifth and Fourteenth Amendments to the Constitution, includes “the right of the individual to contract, to engage in any of the common occupations of life, to acquire useful knowledge, to marry, to establish a home and bring up children, to worship God according to the dictates of his own conscience, and generally to enjoy those privileges long recognized at common law as essential to the orderly pursuit of happiness by free men.”<sup>2</sup> These rights apply as fervently in the case of corporation as they do with individuals.<sup>3</sup>

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<sup>2</sup> Meyer v. Nebraska, 262 U.S. 390, 399 (1923).

<sup>3</sup> A corporation may contract and may engage in the occupations of life, and should be afforded

Although there is no right of an individual or corporation to enter into discretionary government grants or cooperative agreements, that does not mean that the government can act arbitrarily, either substantively or procedurally, against a person or that such person is not entitled to challenge the processes and the evidence before he is officially declared ineligible for such grants or cooperative agreements.<sup>4</sup> Specifically, an applicant or recipient has a right to be free from “stigmatizing” governmental defamation having an immediate and tangible effect on its ability to do business. Thus, the government may not brand or stigmatize an applicant or recipient as “nonresponsible” without granting it notice of specific charges so as to afford it an opportunity to clear its name.<sup>5</sup> It is clear, therefore, that grant recipients and applicants have the right to procedural safeguards before being debarred from future consideration for grants or cooperative agreements.

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no lesser protection under the Constitution than an individual to engage in such pursuits. As the Supreme Court established long ago, a corporation is a person within the meaning of the equal protection and due process clauses. See *First National Bank of Boston v. Bellotti*, 435 U.S. 765, 780 n.15 (1978).

<sup>4</sup> See *Old Dominion Diary v. Secretary of Defense*, 631 F.2d 953, 962 (D.C. Cir. 1980). It should be noted that, while the cases discussed in this article are primarily contract-related cases, federal assistance applicants and recipients have been determined to possess the same due process rights. See *Mainelli v. United States*, 611 F. Supp. 606 (D.C.R.I. 1985). Accordingly, the principles enunciated in the contract cases are instructive in the financial assistance arena as well.

<sup>5</sup> *Hellenic American Neighborhood Action Committee v. The City of New York*, 933 F. Supp. 286 (S.D.N.Y. 1996).

Debarment actions directly implicate due process liberty interests because they have the potential to damage a contractor's or grant recipient's reputation and deprive it of business.<sup>6</sup> Where a person's good name, reputation, honor or integrity is at stake because of what the government is doing to him, notice and an opportunity to be heard are essential.<sup>7</sup> Accordingly, considerations of basic fairness require administrative regulations establishing standards for debarment and procedures which will include notice of specific charges, opportunity to present evidence and, in cases where fact-finding is necessary, to cross-examine adverse witnesses, all culminating in administrative findings and conclusions based on the record so made.

#### HIGH RISK ORGANIZATIONS

Under the Grants Manual, the Grants Officer is charged with determining whether an applicant is sufficiently responsible to receive Federal financial assistance in accordance with requirements established in 15 CFR § 14.14 or 15 CFR § 24.12. Department of Commerce Grants and Cooperative Agreements Interim Manual (Grants Manual), Chapter 9, G.1. The following are examples of indicators used to determine whether a high-risk designation is warranted: (1) financial

instability; (2) inadequate internal controls; (3) unsatisfactory performance under other Federal awards; (4) unsatisfactory audits; and (5) irresponsibility of officials and key employees. Elements reflecting on the responsibility of employees include: a) conviction for such ethical violations as embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, receiving stolen property; b) conviction in other offenses indicating a lack of business integrity; or c) adverse information revealed through the name check procedure which reflects significantly on the applicant's honesty or financial integrity.

Depending on the nature and severity of the evidence with respect to the above referenced factors, the Grants Officer may delay the award until the conditions are corrected, not make the award, or designate the applicant as high risk and make the award with special conditions. Grants Manual, Chapter 9, G.2.<sup>8</sup> In any instance where a Grants Officer intends to deny a grant or cooperative agreement to an applicant on the basis of pre-award concerns relating to the applicant's present responsibility, the applicant must be given notice of the Department's determination. Grants Manual, Chapter 9, G.3. Such a "high risk" determination relates solely to the applicant's present responsibility and the particular award for which the determination is being made, and does not affect, as a debarment would, the applicant's eligibility for future awards. The notice to the applicant must provide an opportunity to the applicant to submit information showing that the Depart-

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<sup>6</sup> *Reeve Aleutian Airways, Inc. v. United States*, 982 F.2d 594 (D.C. Cir. 1993).

<sup>7</sup> *Board of Regents v. Roth*, 48 U.S. 564, 573 (1972); *Wisconsin v. Constantineau*, 400 U.S. 433, 437 (1971). The Supreme Court in *Roth* held that a due process liberty interest was implicated in such situations and, to paraphrase the D.C. Circuit in *Old Dominion Dairy*, to rule otherwise in the case of debarment would drain *Roth* of meaning, something the Supreme Court has taken pains not to do.

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<sup>8</sup> Conditioning a particular award to protect the agency does not implicate the applicant's protected "liberty interest."

ment's determination is in error or otherwise warrants reconsideration.<sup>9</sup> The finding of "high risk" should be included in the award file.<sup>10</sup>

The potential risk of a *de facto* debarment arises when the agency withholds the award for an unreasonable period of time or denies an award as part of a long-term attempt at disqualification, and provides no notice to the applicant and no opportunity to respond. Accordingly, whenever a Grants Officer proposes to make a "high risk" determination which will deny an award based on responsibility concerns, and the denial is part of a long-term plan to disqualify the applicant, the Department's formal debarment and suspension regulations (15 CFR Part 26) must be followed.<sup>11</sup>

#### COMMERCE DEBARMENT AND SUSPENSION REGULATIONS

Executive Order 12549 (51 Fed. Reg. 6370 (1986)) directed executive departments and agencies to participate in a system for debarment and suspension from programs and activities involving Federal financial assistance and non-financial assistance and

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<sup>9</sup> For example, such a notice should state that the Department is not making an award to the applicant, the reasons why, and that the Department's decision becomes final 30 days after receipt of the notice unless the applicant provides information to the Grants Officer prior to that time to show that the Department's decision was in error or otherwise warrants reconsideration.

<sup>10</sup> Grants Manual, Chapter 9, G.5.

<sup>11</sup> Grants Manual, chapter 9, G.3. As a practical matter, government-wide debarment and suspension under 15 CFR Part 26 are used in only the most egregious cases, usually indictment for and/or conviction of criminal offenses.

benefits. In particular, the President ordered that "debarment or suspension of a participant in a program by one agency shall have government-wide effect." The idea behind the order was to ensure that persons found to be unfit to deal with one government agency could not simply begin dealing with a different government agency, and also to avoid the need for duplicative debarment proceedings in each agency.

The Department of Commerce has adopted regulations similar to those of other agencies in recognition of Executive Order 12549 and consistent with the liberty interests at stake. 15 CFR Part 26 provides formal procedures for suspending or debaring applicants or recipients on the basis of nonresponsibility or a lack of integrity.<sup>12</sup> In addition, pursuant to Executive Order 12689 and section 2455 of the Federal Acquisition Streamlining Act of 1994, the Department of Commerce has also established regulations for reciprocal government-wide effect of debarments across procurement and nonprocurement actions.<sup>13</sup> Therefore, if an organization is debarred from procurement contracts under the Federal Acquisition Regulations (FAR), it applies with equal force to financial assistance, and vice versa. There is one debarment list published by the General Services Administration.

Suspension is an action that excludes an organization from participating in financial assistance for a temporary period, pending completion of an

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<sup>12</sup> 15 CFR Part 26 was substantially revised in the issuance of a final common rule on November 26, 2003. See 68 Fed. Reg. 66534.

<sup>13</sup> See 60 Fed. Reg. 33036. August 25, 1995 was the effective date for reciprocity provisions.

investigation and any judicial or administrative proceedings that may ensue.<sup>14</sup> Such action is imposed only when immediate action is necessary to protect the public interest.

With regard to minimum due process, the organization must be afforded its opportunity for rebuttal, but this can be after the suspension is already in effect. It has been consistently held that due process is satisfied so long as an organization which is formally suspended, has a meaningful rebuttal opportunity, whether it be an oral hearing or otherwise, after the suspension.<sup>15</sup> Indeed, the precise requirement announced in *Horne Brothers v. Laird*<sup>16</sup> -that the organization must receive a rebuttal opportunity within 30 days, so as not to “dangle in suspension for a period of one year or more” –has been incorporated into government-wide regulations, including those concerning grants and cooperative agreements.<sup>17</sup> The function of the hearing would be to provide for an independent evaluation of the “adequate evidence” (akin to probable cause) that misconduct has occurred and not to ensure that the organization is guilty.

Debarment is an action taken to exclude an organization from participating in financial assistance on a government-wide basis for the period of the debarment, generally a period of time not exceeding three years.<sup>18</sup> The overwhelming majority of actions taken by the Department under the regulations

thus far have been based upon criminal convictions; this is also true government-wide. The most common scenario is suspension upon indictment and debarment upon conviction. However, in theory, debarment can be based upon performance, financial management, or lack thereof, and other factors. The key issue, in any case, is whether violations can be established which are sufficient enough to meet either of two tests:

- (1) was the violation “so serious as to affect the integrity of an agency program,” or (2) was the violation “of so serious or compelling a nature that it affects the present responsibility of a person.”<sup>19</sup>

Concerning the first test, willful failure to perform in accordance with the terms of the agreement is one example of conduct offered by the regulation which may be sufficient to meet the criterion of affecting the integrity of an agency program. Another example might be an applicant’s repeated failure to correct financial management deficiencies identified in a series of audits.

Regarding the second test, there is no readily apparent example to serve as guidance to determine what conduct is “so serious a nature that it affects the present responsibility of a person.”

Limited guidance is provided by 15 CFR §26.845 which provides that the existence of a cause for debarment does not necessarily require that the person be debarred; the seriousness of a person’s acts or omissions and any mitigating factors are considered in making any debarment decision. This provision should be read as a caution against

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<sup>14</sup> 15 CFR §26.1015.

<sup>15</sup> *Manelli v. United States*, 611 F. Supp. 606 (D.C.R.I. 1985).

<sup>16</sup> 463 F.2d 1268 (D.C. Cir. 1972).

<sup>17</sup> See 15 CFR §26.725.

<sup>18</sup> 15 CFR §§26.930, 26.115 and 26.865.

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<sup>19</sup> 15 CFR §26.800.

debarment except in cases involving the most serious violations and as suggesting that debarment should be reserved for those cases in which a willful or intentional violation can be established.

Following the formal suspension and debarment procedures will provide an applicant or current recipient the required due process in denying or discontinuing financial assistance relationships.

### DE FACTO DEBARMENT

The following general principles concerning *de facto* debarment can be gleaned from the court cases presented as illustrations in the next section of this article. Determinations to deny an award to an applicant for lack of responsibility which involve more than one grant may constitute a *de facto* debarment where the procedural due process guarantees and an opportunity to be heard have not been afforded to the affected applicant. When an agency does not provide the appropriate due process procedures, it may be engaging in an illegal *de facto* debarment. Consequently, an agency may not exclude a potential recipient from receiving an award without invoking 15 CFR Part 26 by making repeated, or even a single, determination to deny an award, if it is part of a long-term plan to disqualify the applicant from receiving any future grants. Thus, an agency cannot leave an applicant “dangling” for an indefinite period of time without affording it the protections of 15 CFR Part 26. *De facto* debarment, therefore, can be shown by the successive denial of a number of awards that would have otherwise been made but for the fact that

the applicant had been “debarred” without due process.<sup>20</sup> Additionally, a finding of *de facto* debarment may be justified at the time of a single determination to deny an award if there is evidence that the agency has decided from that point forward that it would make no further awards to that organization. This single instance is where the “seeds” of *de facto* debarment are planted.

### Illustrations

The recognition and development of the problem of *de facto* debarment can most easily be illustrated via an overview of the following cases in which the government’s actions were found to have constituted illegal *de facto* debarments:

*Myers & Myers v. U.S. Postal Service.*<sup>21</sup> In this case, the organization had been a mail carrier for the last 26 years. Its awards were not renewed, and no reason was given by the agency. The organization was allowed to bid on new awards on which it was the low bidder, but the bids were rejected by the agency because the bidder was considered nonresponsible. The reason for this determination was that the Postal Inspection Service provided information to the contracting officer that the organization had entered into illegal

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<sup>20</sup> It should be noted that repeated determinations of nonresponsibility may not necessarily support a case of *de facto* debarment where the determinations involve practically contemporaneous awards similar in nature, and are based upon essentially the same current information indicating a lack of responsibility. See *Becker and Schwindenhammer*, B-225396, March 2, 1987; and *Standard Tank Cleaning Corp.*, B-245364, January 2, 1992.

<sup>21</sup> 527 F. 2d 1252 (2<sup>nd</sup> Cir. 1975).

subcontracts and had filed fraudulent cost statements. The organization was able to present evidence that the Postal Service's refusal to renew the awards was part of a "sanction" taken against it for claimed irregularities in the firm's operating procedures.

*Old Dominion Dairy v. Secretary of Defense.*<sup>22</sup> Old Dominion was a dairy products supplier which was denied two awards it would otherwise have received but for the fact that the agency had determined in an audit report that it had "knowingly and substantially over billed the government" in past dealings. However, a determination of a lack of integrity was made and communicated through government channels without Old Dominion having been informed of the audit results or been given any written notice that the determination had been made. Denials of the awards could have continued indefinitely with absolutely no recourse for the organization.

*Art-Metal USA, Inc. v. Solomon.*<sup>23</sup> In this case the General Services Administration (GSA) terminated an award with Art-Metal for the convenience of the government and held other awards in abeyance or "suspended animation" that Art-Metal would otherwise have received as the low bidder. GSA was concerned about "public relations" when articles appeared in two local newspapers, reporting on the government's broad-scale investigation into GSA operations, alleging that Art-Metal failed to meet specifications, produced inferior products, and engaged in possible contract abuse.

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<sup>22</sup> 631 F.2d 953 (D.C. Cir. 1980).

<sup>23</sup> 473 F. Supp. 1 (D.D.C. Cir. 1978).

*Shermco Industries v. Secretary of the Air Force.*<sup>24</sup> Shermco Industries alleged that it was *de facto* debarred from February of 1976 to March of 1978. Shermco was indicted in December of 1977 for filing fraudulent claims, and formal suspension was commenced that same month with a final order issued in February of 1978. The agency did not finally initiate suspension action until six months after Shermco was the low bidder on an award and three months after a nonresponsibility determination was made. Suspension was not ordered until seven months after the bid and almost five months after the nonresponsibility determination. These periods of delay were found to be excessive. An agency should not leave an applicant "dangling" for an indefinite period of time while it decides whether to initiate suspension procedures without affording it the protections that are associated with formal suspension and debarment.

*Leslie and Elliot Co., Inc. v. Garrett.*<sup>25</sup> In this case, the contractor was denied two Navy contracts on which it was the low bidder. In addition, the contracting officer considered the contractor to be an administrative burden because an excessive amount of government oversight was required on prior contracts, and he felt the company was submitting fraudulent claims. All of these factors lead the court to conclude that the Navy did not want the contractor to receive any more work on the Navy base.

## CONCLUSION

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<sup>24</sup> 584 F. Supp. 76 (N.D.Tex. 1984).

<sup>25</sup> 732 F. Supp. 191 (D.D.C. 1990).

In any instance where a Grants Officer intends to deny a grant or cooperative agreement to an applicant or recipient on the basis of pre-award concerns related to present responsibility, the applicant or recipient must be given notice of the Department's determination. Such a high-risk determination relates solely to the applicant's or recipient's present responsibility and the particular award for which the determination is being made, and does not affect the applicant's or recipient's eligibility for future awards. On the other hand, where a Grants Officer intends to deny a grant or cooperative agreement to an applicant or recipient on the basis of pre-award concerns related to responsibility, and this denial precludes the applicant or recipient from participation in future awards with the agency, the applicant or

recipient must be afforded its due process rights under the Department's suspension and debarment regulations, 15 CFR Part 26. Failure to follow the required procedures will expose the agency to a valid claim of *de facto* debarment based on an argument by the applicant that it has been denied due process of law and its constitutional liberty interests.

Grants or program officials who are contemplating denying an award for the reasons raised in this article should contact the Federal Assistance Law division at 482-8035 for further guidance.