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THE WHITE HOUSE

WASHINGTON

July 26, 1984

MEMORANDUM FOR BRANDEN BLUM
LEGISLATIVE ATTORNEY
OFFICE OF MANAGEMENT AND BUDGET

FROM: JOHN G. ROBERTS
ASSOCIATE COUNSEL TO THE PRESIDENT

SUBJECT: Statement Concerning Diversion Control Amendments on July 31, 1984

Counsel's Office has reviewed the above-referenced testimony, and finds no objection to it from a legal perspective.

ID # CU

WHITE HOUSE
CORRESPONDENCE TRACKING WORKSHEET

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Date Correspondence Received (YY/MM/DD) 1 1

Name of Correspondent: Gene Haislip

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Subject: Statement concerning Television Control Amendments on July 31, 1984

ROUTE TO:		ACTION		DISPOSITION	
Office/Agency (Staff Name)	Action Code	Tracking Date YY/MM/DD	Type of Response	Code	Completion Date YY/MM/DD
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5/81

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STATEMENT

OF

GENE R. HAISLIP
DEPUTY ASSISTANT ADMINISTRATOR
DRUG ENFORCEMENT ADMINISTRATION

ON

DIVERSON CONTROL AMENDMENTS

BEFORE THE

COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON HEALTH AND THE ENVIRONMENT
UNITED STATES HOUSE OF REPRESENTATIVES

HENRY A. WAXMAN
CHAIRMAN

JULY 31, 1984

Chairman Waxman and members of the Subcommittee on Health and the Environment: It is a pleasure to appear before you and this subcommittee again. The topic of this hearing, the pending legislation to amend provisions of the Controlled Substances Act (CSA) that pertain to the diversion and abuse of legally produced drugs, is very important to DEA and to our nation. The Dangerous Drug Diversion Control Act of 1984 (H.R. 4698 and H.R. 5656) will strengthen our ability to control the diversion of drugs from the legitimate distribution chain into illicit markets.

The abuse of diverted prescription drugs is a major tragedy for our Nation. During the period 1980 -1982 between 60 and 70 percent of all controlled substance mentions involving deaths and injuries were attributable to diverted drugs. Statistics compiled by the National Institute on Drug Abuse indicate that millions of young Americans are abusing stimulants, depressants, tranquilizers and analgesics. The scope of the diversion problem has been well documented in hearings before this Subcommittee, the Subcommittee on Crime, the Select Committee on Narcotics Abuse and Control and other Congressional committees.

The CSA has been, in most respects, a very powerful tool for combatting drug diversion. The widespread diversion from drug manufacturers and distributors which occurred in the late 60's and early 70's was substantially eliminated through the enactment of its provisions. Approximately 5 years ago, DEA initiated a close examination of the CSA to determine where it has and has

not proven to be effective. Our review revealed areas in need of strengthening, clarifying, updating and in some cases where regulatory burden on industry could be eased.

The current House bill, H.R. 5656 as amended, is an outstanding product of several years of effort on the part of ~~experts~~ professionals in the fields of diversion control, drug industry and health ~~professionals~~. The comprehensive set of diversion control amendments were originally incorportaed in Title VII of H.R. 2151, the "Comprehensive Crime Control Act of 1983." Congressional hearings on H.R. 2151 and subsequently H.R. 4698 and H.R. 5656 provided a forum for testimony by a variety of experts from government, the health profession, the drug industry and citizen groups. Each of these groups played a role in refining and shaping the legislation currently before this Subcommittee.

This legislation has received widespread support among the health professions and the drug industry. It is recognized among such groups as a measure that balances the need to increase controls against drug diversion and abuse with the need to avoid unnecessary burdens on those who are part of the health care delivery process.

The following is a brief summary of each of the provisions of H.R. 5656:

Section 1 - Title
Section 2 - Definitions

Section 2 amends Section 102 of the CSA (21 U.S.C. 802) in two major ways. First, it adds a definition for the term "isomer" to clarify a legal issue concerning the control status of certain isomers of controlled drugs produced in clandestine laboratories and also to assure compliance with international treaties. The isomers of the drugs and substances listed in Schedules I and II of the Single Convention on Narcotic Drugs are controlled, as are certain isomers of drugs controlled under the Convention on Psychotropic Substances. Control of optical isomers in the CSA assures United States compliance with the international treaties. Also, clandestine manufacturers have attempted to circumvent the law by manufacturing positional and geometric isomers of hallucinogens in Schedule I and optical and geometric isomers of cocaine. The latter resulting in what has been termed the "isomer defense" in cocaine cases. The isomers of these drugs often elicit similar deleterious pharmacological effects and have no legitimate commercial use. The definition of "isomer" as stated in this title will assure that those isomers which necessitate control under the CSA are clearly covered by the statute.

The second definitional change involves an expansion of the definition of "narcotic drug." This is done in several ways. The definiton of opium and opiates is made more concise, poppy straw and its concentrate (not used commercially in the United States at the time of enactment of the CSA) are added to the

definition, coca leaves are more clearly defined and cocaine and ecgonine are given a specific and detailed listing (the latter assuring consistency with the Single Convention).

Section 3 - Emergency Scheduling

This section creates a new procedure for scheduling substances on an expedited and temporary basis which have no currently accepted medical use in treatment in the United States when they are found by the Attorney General to pose an imminent hazard to the public health. A major target of this provision is what have been called in recent years "designer drugs." These are newly developed chemicals which are often analogs or variations of existing controlled substances such as the PCP analogs, PCE and PHP, and the various analogs of fentanyl, often called "synthetic heroin."

The emergency scheduling provision has been the subject of extensive discussions since the concept was first introduced. The American Medical Association, the American Pharmaceutical Association, the American Veterinary Medical Association, the Pharmaceutical Manufacturers Association and others provided helpful and thoughtful comments on the best way to accomplish the goal of developing an expedited control process for drugs which suddenly arise as major drugs of abuse. The current provision strikes a balance between the need to protect the public from new

drugs of abuse ~~and the evidence of~~ unnecessary burden on those who provide useful drugs for legitimate medical uses.

Paragraph (1) of Section 201(h) provides that the Attorney General by order may schedule a substance in Schedule I without regard to the requirement of 21 U.S.C. 811(b) relating to the Secretary of Health and Human Services if the scheduling is necessary to avoid an imminent hazard to the public safety.

The order may ~~not~~ only be issued after 30 days have elapsed from the date of publication of a notice of intention to issue such a order in the Federal Register along with the grounds upon which such an order is ~~not~~ to be issued, and 30 days have elapsed from the date the Attorney General transmits notice of the poposed order to the Secretary of Health and Human Services. The two 30-day periods may be concurrent.

Paragraph (2) provides that the scheduling shall expire at the end of 1 year from the issuance of the order. However, there is a provision to allow the Attorney General to extend the temporary schedule for up to 6 months if a rulemaking proceeding to schedule the substance has been initiated pursuant to section 201(a)(1) (21 U.S.C. 811 (a)(1)).

Paragraph (3) provides that the Attorney General in finding that a substances poses an imminent hazard to the public safety shall consider three factors in paragraphs (4), (5), and (6) of Section

201(c) relating to "history and current patterns of abuse", scope duration of significance of abuse" and "what, if any, risk there is to the public health".

Paragraph (4) provides that the Attorney General transmit to the Secretary of Health and Human Services notice of the order proposed to be issued under paragraph (1). The Attorney General is directed to take into consideration any comments submitted by the Secretary in response to the transmitted notice, particularly those comments related to factor (6) concerning the risk to the public health.

Paragraph (5) provides that the emergency scheduling order shall be vacated upon the conclusion of a rulemaking proceeding that is initiated to establish whether the substance ought to be scheduled under the formal procedure of Section 201(a)(1) (21 U.S.C. 811(a)(1)).

Paragraph (6) provides that an order issued under this subsection is not subject to judicial review. This conforms to the general practice for temporary, emergency orders such as this procedure.

The Attorney General's authority to issue a temporary scheduling order is limited only to substances for which there is no currently accepted medical use in treatment in the United States.

Section 4 - Exemption Authority

This section clarifies the authority of the Attorney General to exempt from control certain preparations which contain quantitites of controlled substances but which do not pose an abuse threat. These are primarily analytic standards and preparations which are not for use in ~~burdens.~~ humans. They do not present any significant potential for abuse by nature of their formulation but their control would place an excessive burden on both the users of these products and the drug control system. This is a discretionary authority on the part of the Attorney General. The mandatory exception for over-the-counter drugs is not changed.

The section adds a new paragraph (3) to Section 201(g) that permits the Attorney General to exempt by regulation, any compound, mixture, or preparation containing a controlled substance from application of all or any part of the Controlled Substances Act if the compound, mixture or peparation: (A) is approved for prescription use and contains uncontrolled active ingredients in a quantity or proportion that vitiates the potential for abuse, or (B) is not for administration to a human being or an animal and is packaged in a form or concentration, or with adulterants or denaturants, so that as packaged it does not present any significant potential for abuse.

Section 5 - Registration Period for Practitioners

This section amends Section 302(a) (21 U.S.C. 822(a) by authorizing the Attorney General to establish a registration period for practitioners that may be up to three years in duration, but not less than one year. Currently, all registrants are required to register annually. Under this amendment, manufacturers and distributors will continue to register annually.

This amendment will grant authority to the Attorney General to remove, by regulation, the burden of annual registration for practitioner registrants, which make up 98 percent of all DEA registrants. The time and expense of annually completing and filing of application forms for the approximately 600,000 practitioner registrants can potentially be reduced by two-thirds. Paperwork reduction will be significant for both the Government and industry.

In addition to the cost and time savings to registrants, a DEA study estimates that over $700,000 a year could be saved in ~~proceeding~~ processing costs if the registration period were extended to three years. Additionally, reduction in the workload will increase responsiveness to registrant inquiries and avoid delays in the processing of applications.

Section 6 - Practitioner Registration

This section is one of the most important sections of the bill. It amends Section 303(f) (21 U.S.C. 823(f)) relating to the registration of practitioners to expand the authority of the Attorney General to deny registration on public interest grounds.

One clear inhibitor of effective Federal action against practitioner diversion is the limited authority to deny or revoke the Federal registration of practitioners. Currently, the Attorney General must register a physician, pharmacy or other practitioner if they are authorized to dispense by the laws of the state in which they practice. The only grounds upon which DEA may deny or revoke are: (1) if the registrant materially falsifies an application, (2) has been convicted of a drug-related felony or (3) has had their state registration suspended, rovoked or denied. As GAO pointed out in their 1978 report, these limited grounds have contributed to the diversion problem. Because of a variety of legal, organizational, and resource problems, many states do not have the capability to effectively take action against violative registrants as documented by the 1977 DEA study "Comprehensive Final Report on State Regulatory Agencies and Professional Associations." The limitations of state regulatory authorities impacts on the Federal Government's ability to deny or revoke on the state registration criteria. The drug felony criteria also has its limitations. Many controlled drug violations involving

prescription drugs are not felonies under state law and therefore cannot be used in a DEA revocation action. Overloaded Federal court calendars can delay, for years, the prosecution of practitioner violators in Federal court while all the time the violator can continue to operate.

This section adds an additional standard pertaining to consistency with the public interest. The criteria for making such a determination would include the recommendation of the appropriate state licensing or disciplinary authority, prior conviction record with respect to controlled substances, and compliance with applicable Federal, state and local laws relating to controlled substances. This amendment does not provide for a detailed Federal review of all practitioners, but provides the opportunity for action in the most egregious cases.

Current legislation permits the Attorney General to routinely register practitioner applicants. However, in those cases in which such registration is clearly contrary to the public interest, the proposed legislation will permit the Government to move surely and swiftly to eliminate the danger to the public health and safety. The proposed amendment will give the Attorney General the same opportunity as he now has with respect to the registration of other types of registrants to determine whether a practitioner's registration would be in the public interest. At the same time, continued deference is given to the opinions of the state licensing authorities since their recommendations will

be the first of the new factors to be considered in making the public interest determination.

Specifically, this section amends Section 303(f) of the CSA (21 U.S.C. 823(f)) to allow the Attorney General the option of not registering a practitioner who is authorized to dispense or conduct research under the law of the state in which they practice, if issuance of such registration is inconsistent with the public interest. The specific factors that shall be considered are:

(1) the recommendation of the appropriate state licensing or disciplinary authority;

(2) the applicant's past experience in dispensing or conducting research with respect to controlled substances;

(3) the prior conviction record of the applicant under Federal or state laws relating to the manufacture distribution or dispensing of controlled substances;

(4) compliance with applicable Federal, state or local laws relating to controlled substances; and

(5) such other conduct that may threaten the public health and safety.

These factors have been refined with input from the American Medical Association, the American Pharmaceutical Association, the American Veterinary Association, and others. Factor (6) has been redrafted and differs from earlier versions to assure that the focus of the Attorney General's action is on substantive activity on the part of a registrant which threatens the public health and safety. It should also be noted that factor (2) will not in anyway hinder registration of recent graduates of professional schools who may have no professional experience dispensing or conducting research with controlled substances.

Section 7 - Suspension or Revocation of Registration

This section amends Section 304(a) 21 U.S.C. 824(a)) by adding an additional ground for suspension or revocation. Under this new provision, the Attorney General may revoke or suspend a registration upon the finding that the registrant has committed such acts as would render this registration, under Section 303 (21 U.S.C. 823), inconsistent with the public interest. This allows the same standards that are used in determining if a registration is in the public interest to be used in determining if it is no longer in the public interest and should be revoked or suspended. This eliminates the anomaly between the grounds for denial and those for suspension or revocation. This is particularly necessary when the three-year practitioner registration, provided for in Section 5, is considered.

Section 8 - Disposal of Controlled Substances

This section amends Section 304 (21 U.S.C. 824(f)) by establishing authority for the Attorney General to seize or place under seal any controlled substances owned or possessed by a registrant whose registration has expired, or who has ceased to practice or do business. Such controlled substances will be held for the benefit of the registrant, or his successor in interest, for 180 days. At the end of the 180-day period, the Attorney General may dispose of the controlled substances in accordance with the provisions of Section 511(e), which governs the disposal of substances which are forfeited to the Government.

This section gives the Attorney General the necessary flexibility to deal with the quantities of legally acquired controlled substances in the hands of a registrant who is no longer in operation, the storage of which would pose a risk of theft or a hazard to the public health and safety. The proposed amendment also protects the legitimate interest of the registrant for 180 days, during which time proper disposition may be arranged by the registrant. Earlier versions of this legislation called for a 90-day period. Hcwver, the 180-day period will assure protection of property rights when proceedings regarding probate or bankruptcy are lengthy.

Section 9

This section clarifies the recordkeeping provisions for practitioners concern narcotics and non-narcotics and assures that records of dispensing are kept by physicians. The section restructures the recordkeeping requirement and simplifies it to apply to the specific conduct engaged in by the registrant.

Section 307(c)(1)(A) (21 U.S.C. 827(c)(1)(A)) is rewritten to exempt from the recordkeeping requirement the prescribing of controlled substances by practitioners acting in the lawful course of their professional practice. The Narcotic Addict Treatment Act of 1974 (P.L. 93-281, May 14, 1974) required certain recordkeeping with respect to maintenance treatment or detoxification treatment. This is carried forward.

Section 307(c)(1)(B) is rewritten to exempt from the recordkeeping requirement the administering of controlled substances by a practitioner unless the practitioner regularly engages in the dispensing or administration of controlled substances and charges his patients for the substance dispensed or administered. The policy of the current law is carried forward.

Records of dispensing of both narcotics and non-narcotics shall be kept by practitioners. The additional burden on non-narcotic dispensing records will be minimal, but the increase in

accountability will be a major asset to law enforcement. At the present time, a lack of recordkeeping requirements relating to the dispensing of non-narcotic drugs is regarded as a serious deficiency in our ability to detect illicit sale and diversion by practitioners. Investigators auditing the practitioner's records cannot determine if these substances were legally dispensed. This lack of accountability goes against the very basic concept of the "closed system" of drug distribution whose foundation is built on accountability. This amendment eliminates this loophole, while still permitting the exception for prescriptions and administration within the office. Another purpose of this amendment is to continue to eliminate the artificial distinctions between requiremetns for narcotic and non-narcotic substances in the same schedule. State regulatory agencies and the American Pharmaceutical Association have recommended the implementation of more stringent recordkeeping requirements for dispensing physicians.

Section 10 - Change of Address

This section amends Section 307 (21 U.S.C. 827) by adding a new Subsection (g) requiring that dispensers report changes in professional or business addresses within 30 days. This requirement is necessary to eliminate the problem of undeliverable renewal applications that would result when registrant addresses can be up to three years out of date. For the vast majority of registrants, this requirement will have no

effect. On those who do relocate, the burden of notification will be more than offset by the benefit of an extended registration period.

Section 11 - Schedule II Non-Narcotic Penalties

This section raises the penalties for Schedule II non-narcotic substances such as amphetamines and barbiturates to the same level as narcotic penalties. This is the highest basic level in the Controlled Substances Act with respect to any unauthorized manufacturing, distributing, dispensing, or possessing with intent to manufacture, distribute or dispense.

The bill revises the penalty structure so that a 15-year maximum prison term may be imposed for a first offense instead of the current 5-year term. A 30-year sentence may be imposed for a second offense, instead of the current 10-year maximum term.

The fines are also raised from the current maximum of $15,000 (first offense) and $30,000 (second offense) to $25,000 and $50,000 respectively.

Section 12 - Use of An Expired Registration Number

This section amends Section 403(a)(2) (21 U.S.C. 843(a)(2)) by adding the use of an expired registration number to the prohibited acts section that currently prohibits the use of a

number that is fictitious, revoked, suspended or issued to another person.

This amendment eliminates an obvious loophole concerning the use of an expired number and also clarifies the legal status of a registrant who has failed to reapply during the period between the dates on which his registration expired and the receipt and submission of a delinquency notice by DEA. This amendment clarifies the registrant's status during that period by making it unlawful for him to knowingly or intentionally use an expired registration. Concurrent with this amendment, the DEA administrative procedure will be modified to require the mailing of a renewal application 90 days prior to the expiration date of the registration. If the executed application is not received 15 days before the expiration date, a notice of expiration will be mailed to the registrant clearly setting out the fact of expiration and the legal status of the registrant following expiration. No delinquency notices will be sent. This will result in the direct savings to the Government of the mailing and processing costs of approximately 3,200 delinquency notices per month.

Section 13 - State Assistance

This section amends Section 503 (21 U.S.C. 873) by enunciating a responsibility for the Attorney General to address the problem of diversion fo controlled substances from legitimate medical,

scientific and commercial channels by cooperating with and assisting State and local governments and establishing a grant authority for this purpose.

The new Section 503(a)(6) (21 U.S.C. 873(a)(6)) would authorize the Attorney General to make periodic assessments of the capabilities of State and local governments to adequately control diversion, to provide advice and counsel to such governments on methods to strengthen their controls against diversion, and to establish cooperative investigative efforts to control diversion.

The new Section 503(d) (21 U.S.C. 873(d)) would authorize the Attorney General to make grants to State and local governments for specific activities that will enable States to better control diversion. These activities would include collecting and analyzing data on the diversion of controlled substances, conducting investigations and prosecutions of such diversions, improving regulatory controls against diversion, preventing and detecting forged prescriptions, training law enforcement and regulatory personnel to improve the control of diversion and other programs to control diversion.

The recipients of such grants would be required to provde at least a 20 percent cash match and the Attorney General will closely monitor activities carried out under this program and report to Congress annually.

The section also authorizes an appropriation of not more than $6 million for such grant programs for fiscal years 1985 and 1986 only.

The expansion fo the state assistance authority of the Attorney General is a significant step in reducing the diversion of legitimately produced controlled substances. The grant-in-aid provision, combined with increased Federal support in the reas of training, intelligence support, legal assistance and cooperative information exchange, will be part of a comprehensive program aimed at combating practitioner diversion at the state and local level.

The ultimate goal of this Federal assistance would be to have a system of effective state controls at the practitioner level in every state. To acomplish this, an organized system of grants is needed. Coordinated by DEA and directed at the most significant problem areas, this sytem of grants can have a major impact on the ability of individual states to maintain effective controls against practitioner diversion.

Section 14 - Forfeitures

This section amends Section 511(a)(1) (21 U.S.C. 881(a)(1)) to include, as subject to forfeiture, controlled substances possessed in violation of Title II of th CSA. The original

provision only included substances illegally manufactured, distributed, dispensed or acquired, but not illegally possessed.

Section 15 - Importation of Narcotic Raw Materials

This section amends Section 1662(a)(1) (21 U.S.C. 952(a)(1) by adding poppy straw and its concentrate (CPS) to the list of Schedule II controlled substances that may be imported for medical, scientific and other legitimate purposes. This establishes authority in the statute to allow imports of CPS, which the United States has been doing for several years on an emergency basis.

Section 16 - Importation for Scientific, Analytical or Research Purposes

This section amends Section 1002(a)(2) (21 U.S.C. 952(a)(2) by adding a new Subpart (C), that authorizes the importation of limited quantities of any controlled substances in Schedule I or Schedule II and narcotics in Schedule III, IV or V for ultimate scientific, analytical or research uses.

Currently, the statute requires a finding of inadequate competition to allow the importation of unique substances or high quality standards. Since the passage of the CSA, situations

routinely arise in which researchers need specific substances for comparative studies on foreign developed compounds unique in their manufacture. This new section would facilitate and accommodate the acquisition of such substances by legitimate researchers or analytical facilities.

Section 17 - Import Permits

This section amends 21 U.S.C. 952(b)(2) by authorizing the Attorney General to require import permits for any Schedule III non-narcotic controlled substance. Currently, the Attorney General may only require permits for those Schedule III non-narcotics that are listed in Schedule I or II of the Convention on Psychotropic Substances. The Attorney General will continue to be limited to requiring permits for Schedule IV and V non-narcotics to those in Schedule I or II of the Convention.

This amendment provides the Attorney General with the authority to require import permits for any non-narcotic controlled susbtances in Schedule III. This authority will rectify the inconsistency in the Act that requires permits for narcotics in Schedule III but not non-narcotics of equal abuse potential. It also allows for greater control over the importation of highly abused Schedule III non-narcotics.

Section 18 - Export Requirements

Section 18 addresses two major objectives. The first provision clarifies that the documentary proof of foreign approval currently required under Section 1003(e)91) (21 U.S.C. 953(e)(1)) is to be obtained from the country in which the substances are ultimately destined for consumption, not from the country of transshipment. The United States has been a leader in the worldwide effort to curtail diversion of drugs from legitimate commerce. This provision will not only improve our ability to deal with international diversion but will also stimulate other nations to follow our example. The second provision would amend Section 1003(e(2) (21 U.S.C. 953(e)(2)) by providing the Attorney General the authority to require export permits for any Schedule III substance. As in the case with import permits for Schedule III drugs included in Section 17, this provides the Attorney General with the authority to require permits on a drug by drug basis and does not levy permit requirements on all Schedule III drugs.

Section 19 - Registration of Schedule V Exporter

This section amends Section 1007(a)(2) by adding controlled substances in Schedule V to those which may not be exported unless such person is registered or exempt from registration.

Under the current provisions of the CSA, registration is required for specific individual categories of activities. The only anomaly in this "closed system" at present is that separate registration as an exporter was not included for persons exporting Schedule V substances. This has created confusion in the ~~regulatory~~ industry due to the inconsistent requirements. This amendment provides consistency will all other registration requirements of the CSA.

Section 20 - Drug Specific Registration

This section amends Section 1008(b), which currently limits import and export of Schedule I and Schedule II substances to those specified in the registration, by expanding this requirement of specific authorization to individual controlled substances in Schedule III, IV and V.

This amendment will not increase the burden on industry and will greatly enhance the Government's ability to monitor and control the import and export of controlled substances in Schedules III, IV and V.

At present, a registration to import or export in Schedule III, IV or V grants broad authority to conduct activity with any or all substances in the schedule. This makes it difficult to

identify the firms who are importing or exporting particular drug products that are of interest.

Section 21 - Denial, Revocation, and Suspension

This section amends Section 1008 (21 U.S.C. 958) to add a new subsection (d) to set forth in the Controlled Substances Import and Export Act the procedure and standards for denial, revocation and suspension of registrations for importers and exporters. This section eliminates the need to cross-reference Section 304 (21 U.S.C. 824) of the Controlled Substances Act. This section carries forward current law and policy.

That concludes the summary of the provisions of H.R. 5656 and their impact on our ability to deal with the problem of diversion and abuse of legally-produced controlled substances. I might add that this Administration is in the midst of the most extensive effort against drug trafficking in our Nation's history. Because of the magnitude of the diversion problem, the extent of deaths and injuries resulting from diverted drugs and the pervasive impact on our youth, no major effort against drug abuse can be complete without a major initiative against diversion of legitimately produced drugs.

The individuals who handle controlled substances are, in the overwhelming majority, dedicated professionals who are being

given a bad reputation by a relatively small percentage of their profession, however, these unscrupulous persons can have and are having a major impact on this Nation's drug abuse problem. Everyone involved in the drug abuse effort -- Federal and state officials, state regulatory boards, professional and industry associations, concerned citizens -- must work together until this problem is brought under control.

This is one of the important aspects fo H.R. 5656. It has been developed over a period of time through discussion and debate among experts and concerned individuals from many areas of government, industry and the public. This process has developed an effective plan to combat diversion that focuses the effort on the problem while keeping the burden on the lawful to a minimum.

I commend the Chariman, the Members and the staff of this Subcommittee for their continuous support and concern for the efforts against the diversion and abuse of legally-produced drugs. I also commend the monumental effort put forth by Chairman Hughes, his Subcommitte on Crime and its staff. I have seldom witnessed an enterprise that has brought together so many varied people and interests in an organized effort to address one of our nation's most difficult problems -- abuse of diverted drugs.

I urge the Chairman and the Subcommittee to support H.R. 5656 and move forward with this major piece of legislation.

THE WHITE HOUSE

WASHINGTON

July 31, 1984

MEMORANDUM FOR BRANDEN BLUM
LEGISLATIVE ATTORNEY
OFFICE OF MANAGEMENT AND BUDGET

FROM: JOHN G. ROBERTS JGR
ASSOCIATE COUNSEL TO THE PRESIDENT

SUBJECT: Statement of Alfred S. Regnery
Concerning the Office of Juvenile
Justice and Delinquency Prevention

Counsel's Office has reviewed the above-referenced testimony, and finds no objection to it from a legal perspective.

ID # _____ CU

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CORRESPONDENCE TRACKING WORKSHEET

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Subject: Statement of Alfred S. Regnery concerning the Office of Juvenile Justice and Delinquency Prevention

ROUTE TO:		ACTION		DISPOSITION	
Office/Agency (Staff Name)	Action Code	Tracking Date YY/MM/DD	Type of Response	Code	Completion Date YY/MM/DD
CU HOU	ORIGINATOR	84/10/27			/ /
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CU AT 18	R	84/10/27		S	84/10/31
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STATEMENT

OF

ALFRED S. REGNERY
ADMINISTRATOR
OFFICE OF JUVENILE JUSTICE AND DELINQUENCY PREVENTION

BEFORE

THE

SENATE COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON JUVENILE JUSTICE

ON

AUGUST 1, 1984

DRAFT

Thank you very much, Mr. Chairman, for inviting me to testify this morning on the activities of the Office of Juvenile Justice and Delinquency Prevention (OJJDP).

There have been several significant developments concerning OJJDP since I last testified on this subject before the Subcommittee in March. Perhaps the most important development is the substitute legislation drafted by the Administration and the Department of Justice with the cooperation and assistance of the Senate leadership that would create a program of financial and technical assistance for state and local criminal justice, reauthorize OJJDP and establish a program to aid missing children. We appreciate the efforts of this committee in working on this legislation and hope for expeditious final passage.

As you know, Mr. Chairman, the draft substitute amendment would establish, within the Department of Justice, an Office of Justice Assistance (OJA) headed by an Assistant Attorney General. In conjunction with that Office, OJJDP would administer financial and technical assistance at the state and local levels, fund demonstration projects similar to those now authorized, and maintain other previously identified OJJDP priorities. The legislation authorizes a $70 million appropriation for the OJJDP.

Missing Children

In addition, the OJJDP Administrator would be responsible for a new national program, authorized at $10 million per year, for providing training and technical assistance to law enforcement and citizen organizations dealing with missing children issues.

When I last testified, I voiced the Department's support for the Missing Children's program as outlined in S. 2014 and noted OJJDP's plans

for a National Center for Missing and Exploited Children. I am happy to report that the Center was formally opened by President Reagan on June 13th in a ceremony at the White House. Although the Center has been open only a few short weeks, it already has handled hundreds of calls from concerned parents and law enforcement officials and assisted in dozens of missing children's cases. We hope that the Center will be able to assist in even more cases after its telephone hotline begins operation.

The National Center will sponsor and host the first National Conference on Missing and Exploited Children. This conference will bring together highly motivated, experienced professionals who are familiar with the issue of missing and exploited children. These participants will share their expertise with parents, law enforcement personnel, school officials, community leaders and other child advocates to address the problem of missing and exploited children.

Permanent Families for Abused and Neglected Children

My office has recently funded an outstanding prevention program which will focus national attention on the need for providing permanent homes for abused and neglected children. It is being conducted under a $1.5 million grant to the National Council of Juvenile and Family Court Judges.

Studies show that abuse and neglect often cause children to become involved in aggressive, anti-social, and delinquent behavior. Unfortunately, the victim often becomes the aggressor and many of these children go on to become adult criminals. But studies also indicate that a strong and stable family environment can help prevent delinquency. The aim of this program is to find such families for these children.

To aid judges in their decisions in child abuse and neglect cases, the

program will work to recruit and train one million volunteers to be sworn court officers who will devote themselves to a child's case. Such Court-Appointed Special Advocates (CASA) are currently working in CASA programs in 26 states. Through their efforts, placements of children in long-term foster care have been dramatically reduced.

We expect that through this partnership of juvenile and family court judges, volunteers, and others interested in the welfare of children, we can reduce the number of children in foster care, reduce juvenile delinquency and greatly enrich the lives of the nation's abused and neglected children.

Habitual Serious and Violent Juvenile Offenders

The projects I have just described serve the needs of children who come in contact with the juvenile justice system as victims — victims of exploitation, abuse, or neglect. Another new project which we have just funded is aimed at a different group of children. Many of these children also are the victims of abuse or neglect, but the juvenile justice system has failed them. They have not been reached by prevention programs or by the probation or other community-based treatment ordered time after time, offense after offense. Their history of violent and serious criminal behavior necessitates a new approach.

While these habitual, serious and violent juvenile offenders make up only 5-8% of the juvenile population, studies show this group accounts for over 50% of juvenile crime. We believe that concentrating prosecution efforts on this small number of habitual offenders may be the best way of dealing with serious juvenile crime.

OJJDP has awarded a total of $3.7 million to prosecutors in thirteen jurisdictions across the country to establish Habitual Serious and Violent Juvenile Offender programs. Through these programs, cases of chronic

juvenile offenders will be prepared and presented to the courts in an accelerated manner. The programs concentrate on these repeat serious offenders by reducing pretrial, dispositional, and trial delays; restricting or eliminating plea bargaining; reducing the number of dismissals for reasons other than merit; ensuring that all evidence is collected in an admissible manner; improving methods for obtaining the cooperation of victims and witnesses; and assigning one prosecutor to the same case from the time of arrest through final disposition. The programs also include a correctional component that will develop and monitor individualized treatment plans for each adjudicated juvenile offender. This focus on vertical prosecution and continuous case management is intended to increase the consistency of the juvenile justice system in holding a youth accountable for his or her actions.

There are several more general issues in which I understand the Subcommittee is interested and which I would like to discuss one by one.

Peer Review

Mr. Chairman, you have asked about peer review of grant proposals, whether we use that process, and if so, how. We regularly use peer review, both by outside consultants and by our own staff. Our statute authorizes OJJDP to enter into contracts for the partial performance of any of the functions of the Institute, and to compensate consultants and members of technical advisory councils (Section 241 e (4) (5)). We use this provision to employ consultants to review our projects, but we also use an informal review process under which reviewers are not paid. Peer reviews take place at different phases of each project. The form of the peer review process differs, depending on the scope and nature of the program under consideration. During the earliest phase, determining whether OJJDP

should allocate funds to a particular program area, we often seek the opinions of practitioners and researchers regarding the importance of the area, and the critical issues to be addressed. This is usually accomplished through telephone calls, or in conjunction with visits to OJJDP-supported projects. For particularly complex areas, or areas in which there is controversy, a small group of experts is convened to provide advice on program development. We are presently using such an approach in the area of drug abuse and delinquency.

At the proposal stage, peer review can take two forms. Written reviews by outside experts focuses on such issues as significance, feasibility, methodology, and the potential usefulness of the products. We can also elect to convene a panel of experts to assist in identifying the most significant issues, and alternative strategies. As an example, our approach to the area of the quality and accessibility of juvenile records exemplifies a combination of these approaches. In response to the Federal Register announcement of the 1984 Program Plan, we received an unsolicited proposal to review the use of juvenile criminal records in both juvenile and criminal courts. We forwarded this proposal to several experts for their review. Based on their comments, we determined that a panel should be convened to identify the most significant issues concerning the development and use of official records, and to suggest alternative strategies for resolving those issues. That panel will be convened within the next several days to thoroughly review the problem.

Formal applications are reviewed before and/or after award by external experts. This may be accomplished either by selecting consultants through a management contract to review the application on a one-time-only basis, or by establishing a project advisory committee. This

committee reviews the application and all subsequent phases of the research or program development process.

Virtually all final reports on research and program development projects are subjected to peer review. Two to three reviewers are asked to address a comprehensive set of specific questions. The results of the reviews are sent to the authors to provide them an opportunity to make revisions prior to the OJJDP decision regarding publications and dissemination.

Competition and Sole Source Grants

In recent weeks, our critics have made much of the issue of competitive versus non-competitive grants. Press accounts have claimed that we are giving away federal money wholesale to our friends, and that, since becoming Administrator, I have "scrapped" the competitive grantmaking process. Nothing could be further from the truth.

Unlike many grantmaking agencies, we are not required to make grants competitively. We do have policy guidelines however, developed internally, to which we adhere. I have attached a copy of a memorandum to me from the Office of Justice Assistance Research and Statistics (OJARS) Office of General Counsel dated August 8, 1983, which spells out that policy. (Attachment I).

Legislation recently passed by the House of Representatives requires that all new awards made by OJJDP have to be made competitively. The Senate bill does not include such a provision.

Because of the diverse nature of the grants which we give, and because OJJDP makes many small research and special emphasis grants, our grantmaking process is not universally well suited to competition.

We make awards for demonstration projects, research, training, and

technical assistance, as well as certain direct service grants. Although many of these are granted competitively, others would be virtually impossible to grant under the competitive process. For example, our training division has almost never made competitive grants because of the singular nature of its work. There is usually only one organization capable of training the target constitutency. For example, we have given grants to the National College of District Attorneys to train prosecutors. The National College is virtually the only organization in the U.S. that is either equipped to or capable of training prosecutors. Such a grant could not be made competitively. Similarly, training judges and even police officers is best done by individual organizations which have access to those constituencies, which have credibility, and which may have a certain curriculum to teach. Accordingly, we often seek out such organizations and negotiate an award with them. I should point out, however, that we are in the midst of making a competitive grant for training counties in setting up restitution programs for juveniles, which is apparently the first competitive grant that our training division has ever given in the history of OJJDP.

Similarly, the numerous small research grants which we give, many to small research organizations or to individual experts, would be impossible under a competitive process. This is because these researchers will often come to us with a proposal which is unique and which only that researcher is equipped to do. Without having to compete such a process, we are in a position to have such research done quickly and efficiently. It has been estimated that the cost of competing for grants runs upward of $10,000, and the process often takes six months or more. The small researchers, which have been an important part of OJJDP work, have

estimated that if competition were required, they would not be able to afford to compete for our grants, with the result that only the large research organizations and large universities would be able to succesfully compete for our money.

Nevertheless, grants are awarded competitively unless there is a good and compelling reason to do otherwise. So far this year, using special emphasis funds, we have made a total of 43 awards for a total sum of $15,209,000. Of those, 25 were made competitively, for $6,341,000, 13 were made non-competitively for $8,262,000, and 5 awards totaling $605,000 were interagency transfers. We anticipate making at least six additional competitive grants with special emphasis funds, totaling $3,800,000, before the end of fiscal year (FY) 1984, and anticipate making three or four more sole source grants during the remainder of 1984. Accordingly, during FY '84, about half of all awards made with special emphasis funds will have been made competitively.

During FY '83, in all divisions, there were 91 categorical awards made totaling $17,515,000. Of those, 36 were made competitively for $8,081,228, 43 were made non-competitively for $7,626,369, and 12 awards totaling $1,807,183 were interagency transfers and statutorily mandated insular area awards. Thus of the $15,707,579 awarded during FY '83 (which sum excludes insular areas and interagency transfers) more than half of the money was awarded competitively.

In the National Institute of Juvenile Justice and Delinquency Prevention (NIJJDP), all awards made so far in FY '84 have been non-competitive — a total of eighteen awards, for a total of $3,257,000. Only five of those, however, at a total of $1,747,000, were new awards and the remainder were continuations of awards made before I came to OJJDP. We

do have several competitive projects pending in NIJJDP, including a $200,000 project on legal issues, several project evaluations, a project on the quality and availability of juvenile records, and our restitution project, to mention a few.

Delinquency Prevention

We have also been criticized for allegedly ceasing to fund delinquency prevention programs and for concentrating instead solely on prosecution and punishment of juvenile offenders. Again, Mr. Chairman, these reports bear little resemblance to reality.

OJJDP has spent, over the years, tens of millions of dollars on delinquency prevention. Much of this money has been spent aimlessly — that is, spent on the general population whether the general population needed delinquency prevention or not. The result often has been, unfortunately, less than successful, and evaluations of those prevention activities have been almost universally pessimistic.

It has often been said that many delinquency prevention efforts result in doing the right things for the wrong reasons: we have tried to teach people to read to prevent delinquency, we have tried to cure learning disabilities to prevent delinquency, we have built new basketball courts to prevent delinquency, we have purchased mini-bikes for intercity children to prevent delinquency, we have sent children to summer camp to prevent delinquency, to mention a few. Those are things that society should be doing for children anyway, but not in the name of delinquency prevention.

Accordingly, we have tried to redirect our prevention activities, since I have been Administrator, to focus on children who appear to have a higher risk of becoming delinquents, or who, for one reason or another, are more susceptible to prevention activity. So far during FY '84, of the more

than 60 grants signed which I mentioned above, 29 have been for prevention activities, for a total of $12,271,996, and only 18 for control of juvenile delinquents, at a total of $4,180,000. The remainder of our grants fall in neither category. We do anticipate making six additional grants which fall in the control category during the remainder of FY '84, for a total of about $3.8 million. Among those, however, is our restitution project which has a considerable prevention component included in it.

By focusing our prevention activities better, we are both using our money more efficiently and having greater impact on juvenile crime. The Permanent Families for Abused and Neglected Children project, which I described earlier, will focus particularly on dependent and neglected children, a group with an extremely high rate of subsequent delinquent activity. By assisting the juvenile court system in finding permanent homes for those children, we believe that we may have a very significant impact on preventing delinquency. Our grant to Pepperdine University for the National School Safety Center, by the same token, is aimed particularly at preventing delinquency in the schools and, from the experience of similar activities and from what we have learned about school crime and school discipline, we believe that its impact may be significant. Similarly, during 1983, we made a large grant to the Boys Clubs of America, requiring that the Boys Clubs go into the juvenile justice system to recruit children who have already had some contact with law enforcement because of delinquent activity, and bring them into the Boys Clubs for their prevention activities. Previous awards to such groups as the Boys Clubs simply supported their general activities, and a great deal of our money was used for children who were not likely to have become delinquent anyway.

Other examples of some of our prevention awards include the Center

for Community Change here in Washington, D.C., which will provide training and technical assistance to eight neighborhood-based organizations to implement local projects such as providing alternatives to the institutionalization of juveniles and reducing violent juvenile crime and the fear of such crime. In addition, we funded the grant to the Law Enforcement Explorers Scouts, and the five law-related education grants, a project which OJJDP has been involved in for some time. I might add that all of the above grants were made non-competitively.

Among grants we have made to assist the juvenile justice system in controlling juvenile offenders are the thirteen grants to district attorneys which I have already described, training programs for juvenile prosecutors, juvenile judges, police officers, corrections officials, and others within the juvenile justice system, and our private sector corrections grants and our new restitution project, both of which will be funded shortly.

Status of Funds

Mr. Chairman, it appears that we will have spent virtually all of our FY '84 allocations by the end of the fiscal year. We started FY '84 with a total sum of $36,737,648 in discretionary funds, which included both FY '84 allocations and carryover commitments from previous years. As of July 5th, we had actually obligated $19,841,475. Commitments, projects which are in the pipeline, together with projects actually commenced since July 5th will have consumed all but about $2,100,000 of the balance. Thus, we anticipate entering FY '85 with only a small amount of carryover money.

1985 Program Plan

You have asked for information concerning our 1985 Program Plan; we have informed the Subcommittee that it has not yet been completed and is thus unavailable.

We are in the process of developing that plan now, but are somewhat hampered by the fact that our reauthorization has not yet been enacted. As you know, Mr. Chairman, the House bill places significant restrictions on the sort of new programs we can undertake. Therfore, until we know what the final legislation requires, we cannot plan new projects. Nevertheless, we have begun the planning process for 1985, and are reviewing several possible new projects. We will keep the Subcommittee informed of those plans as we progress with them.

We have reviewed the commitments already made for FY '85 funds, which I can report to you. As you know, many of our projects are for a two or three year project period, which means that money for future years will be used for those commitments.

As of July 1st, just over $10,000,000 of our discretionary FY '85 money has been committed. If our total FY '85 discretionary allocation is again approximately $22,000,000, we will have about $10 million to spend on new, discretionary projects.

It is our hope, and the hope of the Administration, that if the OJJDP program is reauthorized, we can continue this important work and, in so doing, improve the quality of juvenile justice in the United States.

Thank you, Mr. Chairman, I will be pleased to respond to any questions you or members of the Subcommittee may have.

ATTACHMENT I

Subject	Date
Competition for Grants and Cooperative Agreements	August 8, 1983

To Alfred S. Regnery
Administrator
OJJDP

From John J. Wilson
Associate General Counsel
OGC, OJARS

This is in response to your request for an opinion regarding the extent to which "competition" is required in the award of grants and cooperative agreements under the categorical grant programs authorized by Title II of the Juvenile Justice and Delinquency Prevention Act of 1974, as amended (Juvenile Justice Act).

Basic Statutory Authority

Section 204(j) of the Juvenile Justice Act authorizes the award of assistance funds to carry out the basic purposes of the Act:

> (j) The Administrator is authorized to make grants to, or enter into contracts with, any public or private agency, organization, institution, or individual to carry out the purposes of this title.

Although this broad grant of authority covers all Title II programs, there is specific award authority for both of the major categorical programs--Special Emphasis and NIJJDP.

Special Emphasis

Special Emphasis authority and the basic progammatic purposes for which funds can be awarded are set forth in Section 224(a):

> (a) The Administrator is authorized to make grants to and enter into contracts with public and private agencies, organizations, institutions, or individuals to--(carry out 12 stated program purposes)

Section 225(a) requires eligible applicants to submit their applications "at such time, in such manner, and containing or accompanied by such information as the Administrator shall prescribe." Section 225(b) requires that each application meet eight requirements that the Administrator shall establish through guidelines. Section 225(c) sets forth criteria which the Administrator shall consider in determining whether to approve applications for Special Emphasis grants.

Institute

Section 241(e)(4) authorizes the Institute to award grants and contracts:

> (e) In addition to the other powers, expressed and implied, the Institute may--
> (4) make grants and enter into contracts with public or private agencies, organizations, or individuals, for the partial performance of any functions of the Institute;

Scope of Discretion

The Administrator of OJJDP exercises discretion by determining what will be OJJDP's program priorities, what amount of funds will be set aside for the priorities selected, and to whom the funds will be awarded. In vesting the Administrator with this discretion, the Congress did not mandate that all categorical funds be awarded pursuant to priorities established through a public comment process or that all programs and projects be awarded through a competitive application review procedure. This is in contrast to the explicit public comment procedures set forth in the Justice System Improvement Act (JSIA) for National Priority and Discretionary Grant programs (JSIA Sections 501-505 and 601-606). Other Federal grant statutes expressly require competition. For example, Section 108(b) of the Domestic Volunteer Service Act of 1973, 42 U.S.C. Section 4958(b) requires that all grants and contracts be "selected through a competitive process" which must include public announcements, stated selection criteria, application submission procedures, and a description of the application review process.

Although the considerations for approval of Special Emphasis applications set forth in Section 225(c) lend themselves to a competitive funding process, it is apparent that this language falls far short of the type of express formal competition mandate seen under the Domestic Volunteer Service Act. This office has had occasion to review the statute and its legislative history on this issue in the past. We have informally advised prior OJJDP Administrators that all categorical funds need not be awarded competitively under the terms and requirements of the Juvenile Justice Act.

However, other statutes, regulations and relevant factors will impact on your decision whether to competitively award particular programs and projects which are to be funded with grants and cooperative agreements.

Additional Considerations Related to Competition

First, it should be pointed out that the reason Congress delegates the discretion to award grants to executive agencies is because of their expertise and ability to establish program priorities, evaluate the best method(s) of implementing those priorities, and implement them in a way that identifies the best applicant's ideas through an objective proposal evaluation process.

Second, Congress has expressed a strong preference that competitive processes be used by the Executive Branch to allocate Federal assistance. The Federal Grant and Cooperative Agreement Act of 1977, repealed and codified as 31 U.S.C. 6301-6308 (Attachment 1), has a statutory purpose to "promote and encourage competition in making grants and cooperative agreements."* OMB's implementing regulations (43 Fed. Reg. 36860, 36863 (1978)) state at para. C(5) that:

> "Consistent with the purposes of Pub. L. 95-224, agencies are encouraged to maximize competition among all types of recipients in the award of grants or cooperative agreements, in consonance with program purposes."

Third, maximum competition provides equity and fairness to potential beneficiaries of Federal grants and cooperative agreements. It gives program staff the opportunity to assess an array of means and methods to achieve statutory goals. In this way, it is anticipated that the best projects and most able recipients will be selected, maximizing the impact of scarce resources on achieving statutory goals.

Fourth, when agencies fail to maximize the use of open competition, criticism from the recipient constituency, Congressional oversight committees, and GAO can be

*Competition has been defined as a process where two or more applicants compete under equal conditions for a limited amount of assistance funds which will be awarded to the applicant(s) who is determined to have the proposal which will best achieve the objective(s) for which the funds are being made available.

anticipated.** In some agencies a legislative remedy has been imposed.***

Fifth, agency policy currently mandates maximum open competition. Instruction I4510.2 issued September 14, 1979, establishes as basic agency policy that:

> "Program objectives for which grants and other agreements may be made should be covered by program announcements. Competition for assistance shall be furthered to the maximum extent practicable by furnishing the public with sufficient and timely information, including publication of program information in the Federal Register." (I4510.2, par. 4)

The only exception recognized by this policy is where an unsolicited application of outstanding merit is recieved that is not within the scope of an announced program (par. 4(e)). Related Instructions are:

> (1) I4560.4, September 14, 1979, which requires that panel review mechanisms be established for each categorical grant program; and
>
> (2) I4040.2, September 14, 1979, which establishes the project period system of obligating funds for Categorical Grants and Cooperative agreements.

The above quoted agency policy for competitive categorical grant funds is consistent with the recommendations of the Administrative Conference of the United States with respect to the distribution of Federal discretionary grant funds. The Conference recommendations are set forth at 1 C.F.R. Part 71. In Section 305.71-2, the Conference recommendation states:

> "...in dispensing assistance agencies should not be free to act completely within their own discretion, ad hoc, unguided by standards

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**See Comptroller General, "Labor Needs to Better Select, Monitor, and Evaluate its Employment and Training Awardees," B-203219, August 28, 1981 at pp. 6-10. GAO concludes that the contract procurement principle of full and free competition, where practicable, and the related principle that all non-competitive procurements should be fully justified, is equally applicable to categorical grant awards.

***See Federal Grant Law, Grant Rule Making, by Malcolm S. Mason, Part III - "Poor Rule Making and Its Congressional Cure".

and insulated from the complaints of those who dispute the propriety of agency decisions. Such unchanneled discretion not only creates the occasion for arbitrary action, but also prevents the agencies from giving their programs the effective policy direction essential for the achievement of statutory aims."

Sixth, in terms of the exercise of discretion, the failure to follow the principles and standards set forth in the Federal Grant and Cooperative Agreement Act, OMB implementing regulations, GAO guidance, express agency policy, and the Administrative Conference recommendations may constitute a basis for legal challenge to non-competitive award decisions.

The Administrative Procedure Act, 5 U.S.C. Section 706, provides that in reviewing challenged agency action, a reviewing court shall--

> "(2) hold unlawful and set aside agency actions, findings, and conclusions found to be--
>
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;..."

Although one could argue that the matter of competition is within the discretion of the Administrator and that there are valid reasons for not utilizing competition (see below) it is possible that a court could rule, in the absence of articulated policy and standards for such a decision, that the failure to use competitive award procedures is arbitrary, capricious, and an abuse of discretion. To date there is no caselaw on this issue. This is primarily because a potential grantee has historically had difficulty establishing either a jurisdictional basis for such a suit or the requisite standing, particularly in the absence of having submitted an application for funding in response to a program announcement and with some form of competitive review. If a court were to take jurisdiction and find that a plaintiff had standing, OJJDP could argue that the decision to fund noncompetitively is justified because:

(1) Competition is cumbersome and expensive;

(2) Competition leads to delay in program implementation;

(3) Competition results in loss of program flexibility and discretion in determining how projects will operate;

(4) Competition leads to a greater number of disputes on procedural matters;

(5) Competition rewards "grantsmanship" rather than quality project concepts; and

(6) Competition limits opportunity for less experienced or new grantees.

If you find that it is desirable to use competition where appropriate but wish to increase program flexibility beyond that which is currently provided by agency policy, several additional areas of exception to the agency policy stressing competition could be considered for adoption as OJJDP policy:

(1) projects with special time constraints;

(2) supplements to cover unanticipated costs of funded projects or to increase the scope of funded projects;

(3) jointly funded projects;

(4) unsolicited proposals of outstanding merit which are outside the scope of planned competitive programs;

(5) unusually complex programs;

(6) limited demonstration test or pilot projects which are to conducted at sites where the agency is in a position to evaluate the suitability of all potential applicants and determine which one(s) can best carry out the purpose(s) of the program or project;

(7) research projects where a particular organization possesses a unique data base or has access to a unique research opportunity; and

(8) special emergency or impact projects which result from unique or special needs of specific grantees.

I am available to you or to OJJDP staff should you wish further consultation on this matter.

THE WHITE HOUSE

WASHINGTON

July 31, 1984

MEMORANDUM FOR BRANDEN BLUM
LEGISLATIVE ATTORNEY
OFFICE OF MANAGEMENT AND BUDGET

FROM: JOHN G. ROBERTS
ASSOCIATE COUNSEL TO THE PRESIDENT

SUBJECT: DOJ Testimony on Implementation of Export Trading Company Act of 1982

Counsel's Office has reviewed the above-referenced testimony, and finds no objection to it from a legal perspective.

ID # _____ CU

WHITE HOUSE
CORRESPONDENCE TRACKING WORKSHEET

John

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☐ H - INTERNAL
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Date Correspondence Received (YY/MM/DD) 1 1

Name of Correspondent: John Logan

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Subject: DOS Deterioney on Implementation of the Export Trading Company Act of 1982

ROUTE TO: | **ACTION** | **DISPOSITION**

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ACTION CODES:
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F - Furnish Fact Sheet to be used as Enclosure
I - Info Copy Only/No Action Necessary
R - Direct Reply w/Copy
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S - Suspended

FOR OUTGOING CORRESPONDENCE:

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U.S. Department of Justice
Office of Legislative and Intergovernmental Affairs

Office of the
Assistant Attorney General

Washington, D.C. 20530

July 30, 1984

SPECIAL

TO: Connie Bowers
OMB

FR: John Logan
OLIGA (633-2078)

RE: Testimony on Implementation of the Export Trading Company Act of 1982 for clearance

Attached is the Department's statement on the above subject before the Subcommittee on International Policy and Trade of the House Foreign Affairs Committee for August 1, 1984, for OMB review and clearance.

cc: Fred F. Fielding

DRAFT

STATEMENT OF

CHARLES F. RULE
DEPUTY ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL
POLICY AND TRADE
COMMITTEE ON FOREIGN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

IMPLEMENTATION OF THE EXPORT TRADING COMPANY ACT OF 1982

ON

AUGUST 1, 1984

Mr. Chairman and members of the Subcommittee:

I am pleased to be here today to discuss with you the Export Trading Company Act of 1982 ("ETC Act" or the "Act") and how it is being implemented by the Department of Justice. 1/ The Act was passed by Congress under the leadership of Subcommittee Chairman Bonker in an effort to encourage U.S. exports and in the belief that there are many U.S. companies that could--but do not--export goods and services.

Title I of the Act sets forth the purpose of the Act and establishes an office of export trade in the Department of Commerce. 2/ Title II permits bank holding companies and similar entities to become involved in export trading companies. 3/

Titles III and IV are the antitrust titles. 4/ They respond to complaints that the antitrust laws are a barrier to various kinds of export activities. In fact, the antitrust laws, properly understood and applied, would prevent few export activities. Congress concluded, however, that the perception of possible antitrust exposure could deter perfectly lawful

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1/ Pub. L. 97-290, 96 Stat. 1233-47, signed into law by President Reagan October 8, 1982, and its implementing regulations at 15 C.F.R. Part 325.

2/ 15 U.S.C. § 4001-3.

3/ 12 U.S.C. §§ 1841-43; 12 U.S.C. § 372.

4/ 15 U.S.C. §§ 4011-21.

export activities. Accordingly, in Title III of the Act, Congress permitted persons to obtain "certificates of review" that provide limited antitrust immunity for certain export trade activities. Title IV of the Act, the Foreign Trade Antitrust Improvements Act of 1982, clarified the subject matter jurisdiction of the antitrust laws.

Certificates of Review

Title III of the Act provides that the Secretary of Commerce, with the Attorney General's concurrence, may issue export trade certificates of review to any applicant for "export trade, export trade activities, and methods of operation" that meet the standards of the Act. To qualify for a certificate, the conduct must:

> (1) result in neither a substantial lessening of competition or restraint of trade within the United States nor a substantial restraint of the export trade of any competitor of the applicant,
> (2) not unreasonably enhance, stabilize, or depress prices within the United States of the goods, wares, merchandise, or services of the class exported by the applicant,
> (3) not constitute unfair methods of competition against competitors engaged in the export of goods, wares, merchandise, or services of the class exported by the applicant, and
> (4) not include any act that may reasonably be expected to result in the sale for consumption or resale within the United States of the goods, wares, merchandise, or services exported by the applicant. 5/

5/ § 303(a)(1)-(4), 15 U.S.C. § 4013(a).

Congress intended these standards to be entirely consistent with existing antitrust law and to help clarify the applicability of antitrust law to export-related conduct. 6/ In this regard, the amendment to the Sherman Act accomplished by Title IV of the Act clarifies that there is jurisdiction with regard to export trade only when the conduct produces "a direct, substantial, and reasonably foreseeable effect" on domestic or import commerce, or a U.S. firm's export trade. 7/ This amendment codifies the mainstream of legal precedent and is consistent with past Antitrust Division practice.

Thus, certificates of review are not intended to immunize conduct which would have anticompetitive effects on domestic commerce and thus harm U.S. consumers. A certificate is issued only in a case where the conduct would otherwise be lawful and thus would not harm U.S. consumers. A certificate provides antitrust certainty, in that a certificate holder receives substantial practical protection from antitrust suits. No criminal or civil antitrust action can be brought against a person who has been issued a certificate of review for conduct specified in and in compliance with the certificate. 8/ The

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6/ "The Conferees intend that the standards set forth in this subsection encompass the full range of the antitrust laws." H. Rep. No. 97-924 (97th Cong. 2nd Sess.) 26 (1982).

7/ 15 U.S.C. § 6a.

8/ 15 U.S.C. § 4016.

Act does provide that the Department of Justice may file suit to enjoin conduct threatening clear and irreparable harm to the national interest. 9/

In addition, a person injured by conduct covered by a certificate may challenge the conduct, and if it is found to violate the standards of the Act, the injured person may obtain an injunction and recover actual--not treble--damages. While successful private plaintiffs may recover their attorney's fees, plaintiffs must pay the defendant's attorney's fees if they do not prevail in the litigation. 10/ Thus, while the Act's substantive requirements for certification do not differ from substantive standards applicable under the antitrust laws, the fact that certificate holders are exposed to single rather than treble damages and the potential liability for defendant's legal fees should discourage frivolous or ill-founded challenges to certified export conduct.

Department of Justice Responsibilities and Experience Under Title III

The Act requires that the Secretary of Commerce, with the concurrence of the Attorney General, issue regulations to carry out the Act, and further provides that the Secretary of Commerce with the concurrence of the Attorney General may issue

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9/ § 306(b)(5), 15 U.S.C. § 4016(b)(5).

10/ § 306(b)(1)-4, 15 U.S.C. § 4016(b)(1)-(4).

guidelines to promote greater certainty regarding the application of the antitrust laws to export trade. 11/ Accordingly, the Department of Justice worked closely with the Department of Commerce to issue regulations and guidelines. In addition, we developed our own internal procedures for efficient processing of applications. We held a seminar prior to the Act's effective date for all Division supervisors, and circulated materials explaining the Act and our procedures to all appropriate Division sections and offices.

I would now like to describe how applications are handled at the Department of Justice and the substantive analysis we employ. Throughout, I will incorporate specific references to some of our experiences under the Act.

Any person (not just an export trading company) may file an application for an export trade certificate of review. The Department of Commerce is required to transmit each application within seven days of its submission to the Antitrust Division of the Department of Justice, which has been delegated by the Attorney General to process the applications. 12/ Within ten days of receipt of the application, the Department of Commerce

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11/ §§ 310, 307, 15 U.S.C. §§ 4020, 4017.

12/ The Title III functions of the Attorney General were delegated to the Assistant Attorney General in charge of the Antitrust Division. 28 Fed. Reg. 9523, March 7, 1983; 28 C.F.R. §§ 0.40-41.

is required to publish in the Federal Register notice of the application identifying the applicants and describing the conduct for which the application has been made. 13/ The confidentiality of the applicant's financial and proprietary business information is protected by exemption from the Freedom of Information Act 14/ and by disclosure prohibitions on the Departments of Commerce and Justice staff reviewing the applications or certificates. 15/ The statute requires that the two agencies determine within ninety days whether the application meets the standards for a certificate of review. 16/ The Act and the regulations permit some applications to be processed on an expedited schedule of forty-five days rather than ninety days, if the applicant demonstrates a "special need" for an earlier decision. 17/ No certificate may be issued earlier than thirty days from the date of publication in the Federal Register. 18/ To date, two applicants have requested and received certificates issued on an expedited

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13/ 15 U.S.C. § 4012(b).

14/ § 309(a) (5 U.S.C. § 552), 15 U.S.C. § 4019.

15/ § 309(b)(1), 15 U.S.C. § 4019.

16/ § 303(b), 15 U.S.C. § 4013(b). This time period can be extended, pursuant to the regulations, if there is a request for additional information. 15 C.F.R. § 325.

17/ § 303(c), 15 U.S.C. § 4013(c).

18/ 15 C.F.R. § 325.7.

basis. If a certificate is issued, the Commerce Department publishes a summary in the Federal Register. If a certificate is denied, the Commerce Department publishes a notice of the denial. 19/

Each application received from the Department of Commerce is assigned to a section of the Antitrust Division which has expertise in the products or services involved in the application. An attorney and an economist are assigned to work with Department of Commerce personnel to ensure that we have all the information needed for our analysis and to help prepare an appropriate certificate. We evaluate whether the applicant and the proposed conduct are eligible for certification under the Act and whether the proposed conduct meets the Act's four standards. Because those standards are essentially the competition standards of the antitrust laws, our analysis is essentially the same one we apply to other proposed export conduct under the Department's Business Review Procedure 20/ or in other typical antitrust analysis. The conduct involved in export trade certificate applications is, naturally, export conduct, so we most frequently begin our analysis by referring

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19/ 15 C.F.R. § 325.5(c).

20/ Under that procedure, which is set forth at 28 C.F.R. § 50.6, parties may obtain a statement of the Department's present enforcement intention with respect to a specified proposed course of conduct.

to Title IV of the Act, which codifies the rule that the antitrust laws apply only to conduct with an effect on the U.S. market or on a U.S. firm's export trade.

Upon completion of its analysis, the staff prepares a recommendation which is reviewed in turn by the chief of the relevant section, the Director of Operations, and the Deputy Assistant Attorney General for Regulatory Affairs. The decision whether to concur with the Department of Commerce that a certificate should be issued is made by the Assistant Attorney General in charge of the Antitrust Division.

I turn now to a description of the analysis we must perform to determine whether or not proposed conduct is certifiable. It is important to emphasize that the Act authorizes no conduct that would otherwise violate the antitrust laws. Thus, our analysis focuses on whether the proposed conduct is likely to have a substantial anticompetitive impact on either U.S. domestic commerce or on the export opportunities of other U.S. exporters. Conduct that has anticompetitive effects only in foreign markets would not ordinarily violate the U.S. antitrust laws and therefore may be certified. However, an export trade certificate of review does not protect U.S. companies from the antitrust laws of other countries.

In general, in determining whether proposed conduct is likely to have an anticompetitive effect in the United States or on U.S. exporters' opportunities, we consider the purpose of

the arrangement, the economic power of the applicant, and the potential anticompetitive consequences to domestic commerce or to U.S. export competitors that may result.

The applications that we have received can be roughly divided into two groups: one group is firms seeking certification for single-firm conduct and vertical conduct; the other group is applicants seeking certification for agreements among direct competitors. The first group, generally proposing agreements between a manufacturer and a distributor, or between a distributor and a foreign sales representative, usually presents few antitrust issues. When we look at vertical conduct in connection with exports, we find that such conduct is unlikely to have substantial anticompetitive consequences in the United States. Such conduct--if it takes place in the United States--is usually examined under the rule of reason. Continental TV, Inc. v. GTE Sylvania, 433 U.S. 36 (1977).

For example, Equinomics, Inc., is a small, minority-owned, general export trading company in New Orleans that seeks to represent other companies in exporting a wide variety of products; the Trade Development Corporation of Chicago is a company that seeks to export to Asian markets phonographic records and prerecorded tapes; commercial aircraft; bolts, nuts, rivets, washers; computer programming and software; and management and public relations consulting services. The certificates granted to these or similar applicants typically

certify them to appoint and terminate exclusive foreign distributors and to be the exclusive export representative for a U.S. producer.

The other group is of those applicants seeking certification for agreements among competitors. With such agreements, there is a greater possibility of anticompetitive effects in domestic markets. For example, the exchange of price or other sensitive business information, and the possibility that the trading entity may be used as a vehicle for illicit agreements or as a means to raise prices, have potential anticompetitive effects, and will be carefully scrutinized. However, agreements among competitors also can be procompetitive or competitively neutral and thus not violate the antitrust laws.

In examining them, we look at the market structure of the industry involved: the number and size of competitors in the relevant market; the market share of the partners of the joint venture; the adaptability of a line of commerce to noncompetitive practices; and the potential economic power of the trading entity. We are particularly concerned where most or all of the firms in an industry are affiliated and supply is not easily expanded. There have been very few applications to date from groups that represent a large share of the U.S. competitors in a given industry. Certificates can be issued to such groups, however, if the conduct for which certification is

sought does not involve significant risks of domestic collusion; significant competitors remain outside the venture; the market structure is not conducive to successful collusion; there are adequate limitations or conditions in the certificate; or some combination of these and other factors ensures that the standards of the Act are met.

Specific examples of certificates issued to groups of competitors include: the U.S. Farm-Raised Fish Trading Company, Inc., a group of competing catfish producers that have banded together to develop overseas markets for catfish; and Northwest Fruit Exporters, a group of Washington and Oregon cherry producers that have joined forces to sell cherries to Japan in compliance with Japanese government requirements.

Because certificates of review confer limited antitrust immunity, we must be careful that they describe precisely the conduct that is covered by the certificate. Vague or imprecise language could result in an overbroad grant of antitrust immunity to conduct that was not intended to be covered, or in protection of plainly anticompetitive conduct that arguably is covered by a certificate. Conversely, it could subject a certificate holder to antitrust liability for conduct which, because of imprecise language, had incorrectly been assumed was covered by the certificate.

Applications for certificates were first accepted on June 9, 1983. Since that time, sixty-three applications have been

received and thirty-two certificates have been issued. Eleven other applications are pending. The remainder were withdrawn by the applicants when the Commerce Department found that they were incomplete or the applicant decided to reformulate its application; many of these firms subsequently reapplied. No application has been denied, and no certificate has, to this date, been challenged in court. Applicants have generally been small or medium-sized companies, as Congress intended when it passed the Act. 21/

The Commerce Department has responsibility for development and promotion of U.S. exports. We at the Department of Justice do not attempt to duplicate the promotional efforts of the Department of Commerce. We have, however, attempted to educate the antitrust bar about the Act through speeches and participation in educational programs. In addition to these efforts, the Department of Justice has contributed to the clarification of the applicability of the antitrust laws to export-related business conduct though the "Antitrust Guide to International Operations" (1977) and its Business Review Procedure.

Mr. Chairman, in summary, Department of Justice procedures to implement the Act are in place and they are functioning well. We have encountered no significant obstacle or problem

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21/ See § 102(a)(4), 15 U.S.C. § 4001.

in implementing the Act. We will continue our efforts to fulfill effectively and efficiently our responsibilities under this Act.

Mr. Chairman, that completes my prepared remarks. I would be pleased to respond to any questions you or the Subcommittee members may have.

Thank you.