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New International Consequences Of Suspension and Debarment

by
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I. INTRODUCTION

On April 7, 1988, the U.S. State Department published in the Federal Register a major amendment to the International Traffic in Arms Regulations¹ (ITAR). One of the changes contained in this regulation is a provision, in part based on recent amendments to the Arms Export Control Act² (AECA), that permits the State Department to deny or revoke export licenses issued to companies that are ineligible to contract with the U.S. government.

This amendment of the ITAR marks the first time that export privileges have been linked to an exporter's "present responsibility" as a government contractor. The regulation lacks administrative standards for its implementation by the State Department, and could lead to a draconian *per se* denial approach for exporters who are suspended or debarred from government contracting, even where the suspension or debarment has no relation to the foreign policy and national security interests underlying U.S. export control laws. The regulation should, therefore, be substantially refined and narrowed in scope.

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1. 22 C.F.R. §§ 120-28 (1988).

2. 22 U.S.C. § 2778(g) (Supp. V 1987).

II.

THE ITAR AMENDMENT OF APRIL 7, 1988

A. Background of the Regulation

1. Congressional Scrutiny of the Office of Munitions Control

The April 7, 1988 revision of the ITAR was promulgated under authority of recent amendments to the AECA.³ These amendments, enacted in December 1987, followed a year of intense congressional interest in the arms licensing procedures of the State Department, including two hearings of the Senate Committee on Governmental Affairs, chaired by Senator John Glenn (Democrat, Ohio).⁴

In the course of these hearings, the State Department Office of Munitions Control [hereinafter OMC] identified a number of perceived shortcomings in export licensing procedures. A significant shortcoming which was identified by the OMC was the lack of substantive guidelines for approval or disapproval of export license applications.⁵ For example, prior criminal behavior or a criminal record was not a basis for denying an export license.⁶ Of the approximately 49,000 license applications received in 1986, only approximately 600 applications were rejected.⁷

The OMC itself has no established debarment procedures.⁸ Indeed, the OMC does not even keep its own records of firms or individuals which have been debarred from exporting.⁹ Rather, it relies on a list of such persons published by the Commerce Department.¹⁰

Senator David Pryor identified as particularly disturbing the possibility that a substantial number of arms traders were not reporting agents' fees in excess of \$100,000 as required by law.¹¹ There were only twenty-three such reports made in 1986, a year in which the OMC processed nearly 50,000 export license applications.¹² Senator Pryor deemed "preposterous" the suggestion that only twenty-three arms traders received fees in excess of \$100,000 that year.¹³

3. *See id.*

4. *Federal Licensing Procedures for Arms Exports: Hearing Before the Senate Comm. on Governmental Affairs*, 100th Cong., 1st Sess. (1987) [hereinafter Hearing I]; *Report by the General Accounting Office on Arms Exports Licensing at the Department of State: Hearing Before the Senate Comm. on Governmental Affairs*, 100th Cong., 1st Sess. (1987) [hereinafter Hearing II].

5. Hearing I, *supra* note 4, at 15-16 (colloquy between Sen. Pryor and Mr. Joseph Smaldone, Office of Munitions Control, U.S. State Department); *id.* at 17 (statement of Sen. Pryor); *id.* at 19 (colloquy between Sen. Bingaman and Mr. Joseph Smaldone).

6. *Id.* at 20 (colloquy between Sen. Bingaman and Mr. Clyde Bryant, Office of Munitions Control, U.S. State Department).

7. *Id.* at 15 (statement of Sen. Pryor).

8. *Id.* at 16-17 (colloquy between Sen. Pryor and Mr. Clyde Bryant).

9. *Id.*

10. *Id.*

11. *Id.* at 31-32 (colloquy between Sen. Pryor and Mr. Clyde Bryant).

12. *Id.*

13. *Id.*

2. *The Foreign Relations Authorization Act*

As a direct result of congressional interest in the OMC and the arms licensing process, the Foreign Relations Authorization Act was passed, significantly amending the AECA.¹⁴

a. *Denial of Export Privileges for Violation of Criminal Statutes*

The first of these amendments provides that the President may disapprove an application for an export license if he determines that: (1) an applicant is under indictment for certain export or foreign affairs related offenses, or (2) there is "reasonable cause to believe" that an applicant has committed such an offense.¹⁵ The President must disapprove an application for export license if the applicant, or any "party to the export,"¹⁶ has been convicted for violation of one of the enumerated criminal statutes.¹⁷ Disapproval under this provision is clearly not discretionary.

14. Foreign Relations Authorization Act, Pub. L. 100-204, § 1255(a), 101 Stat. 1429, 1429-31 (codified at 22 U.S.C. § 2778(g) (Supp. V 1987)).

15. 22 U.S.C. § 2778(g)(3) (Supp. V 1987). The criminal statutes that can serve as a basis for export license disapproval under the statute are as follows:

- (i) this section [section 38 of the Arms Export Control Act, 22 U.S.C. 2778],
- (ii) section 11 of the Export Administration Act of 1979 (50 U.S.C. App. 2410),
- (iii) section 793, 794, or 798 of title 18, United States Code . . . (relating to espionage involving defense or classified information),
- (iv) section 16 of the Trading with the Enemy Act (50 U.S.C. App. 16),
- (v) section 206 of the International Emergency Economic Powers Act (relating to foreign assets controls; 50 U.S.C. App. 1705),
- (vi) section 30A of the Securities Exchange Act of 1934 (15 U.S.C. 78dd-1) or section 104 of the Foreign Corrupt Practices Act (15 U.S.C. 78dd-2),
- (vii) chapter 105 of title 18, United States Code . . . (relating to sabotage),
- (viii) section 4(b) of the Internal Security Act of 1950 (relating to communication of classified information; 50 U.S.C. 783(b)),
- (ix) section 57, 92, 101, 104, 222, 224, 225, or 226 of the Atomic Energy Act of 1954 (42 U.S.C. 2077, 2122, 2131, 2134, 2272, 2274, 2275, and 2276),
- (x) section 601 of the National Security Act of 1947 (relating to intelligence identities protection; 50 U.S.C. 421), or
- (xi) section 603(b) or (c) of the Comprehensive Anti-Apartheid Act of 1986 (22 U.S.C. 5113(b) and (c)).

Id. § 2778(g)(1)(A).

16. The statute defines "party to the export" to mean:

- (i) the president, the chief executive officer, and other senior officers of the license applicant;
- (ii) the freight forwarders or designated exporting agent of the license application; and
- (iii) any consignee or end user of any item to be exported

Id. § 2778(g)(9)(D).

17. *Id.* § 2778(g)(4). The statute provides an exception to this prohibition as well as to export debarment and suspension, *infra* p. 6, if the President finds in a particular case that "appropriate steps have been taken to mitigate any law enforcement concerns." *Id.*

b. *Export Debarment and Suspension*

The President must also disapprove an application for an export license if the applicant, or any party to the export, is ineligible to receive export licenses or any other forms of export authorization from any agency of the U.S. government.¹⁸

c. *Government Contract Debarment and Suspension*

Further, the statute provides that the President may disapprove an application for an export license if the applicant "is ineligible to contract with,¹⁹ or to receive a license or other form of authorization to import defense articles or defense services from, any agency of the United States Government."²⁰ The power to disapprove license applications under this provision, in contrast to the two preceding provisions, is clearly discretionary.

B. *Implementation of the AECA Amendments in the ITAR*

The AECA's provision linking government contract debarment with denial of export privileges is implemented in a new section of the ITAR. This section provides:

Any application for an export license or other approval under this subchapter may be disapproved, and any license or other approval or exemption granted under this subchapter may be revoked, suspended, or amended without prior notice whenever:

(1) The Department of State deems such action to be in furtherance of world peace, the national security or the foreign policy of the United States, or is otherwise advisable; or

. . . .

18. *Id.* § 2778(g)(4).

19. Neither the amendment to the AECA nor the revised ITAR defines the phrase "ineligible to contract with" the government; nor is there any discussion in the legislative history of what Congress meant by this phrase. The government contract debarment/suspension regulations define "debarment," "suspension," and "ineligibility." 48 C.F.R. § 9.4 (1987). Debarment is a government action which excludes a contractor from contracting with the government for "a reasonable, specified period." *Id.* § 9.403 Suspension is a similar disqualification which is instituted temporarily, generally pending investigation of alleged wrongdoing by the contractor. *Id.*

"Ineligibility" means that a contractor is "excluded from government contracting . . . pursuant to statutory, Executive order, or regulatory authority other than [FAR pt. 9.4] . . ." *Id.* § 9.4.

The question, therefore, is whether Congress intended the phrase "ineligible to contract with" the Government to encompass only "ineligibility" as defined by 48 C.F.R. section 9.4, or all three types of disqualification within 48 C.F.R. section 9.4. This question is further complicated by the newly amended preamble to the ITAR, which refers only to debarment:

Amended section 38 of the Act and the final rule authorize the Office of Munitions Control to deny licenses or other approvals to individuals or firms who have either been indicted for or may have committed violations of various statutes; or who have been *debarred by agencies of the U.S. Government from importing defense articles or defense services, or from contracting with the U.S. Government.*

53 Fed. Reg. 11,494 (1988) (emphasis added).

20. 22 U.S.C. § 2778(g)(3)(C) (Supp. V 1987).

(5) An applicant is ineligible to contract with, or to receive a license or other authorization to import defense articles or defense services from, any agency of the U.S. Government²¹

There are significant legal problems with newly amended section 126.7(a)(5) of the ITAR. First, the new rule provides the OMC with apparently unrestricted authority to deny, revoke, suspend, or amend export licenses of firms or individuals declared ineligible to contract with the government.

Second, the 1987 amendments to the AECA, pursuant to which the ITAR amendments were promulgated, were enacted to require that the State Department systematically review license applications and to assure that export licenses are granted only when consistent with the existing policies governing the licensing of arms exports.²² Section 126.7(a)(5) is contrary to both the letter and the spirit of these statutory amendments. It appears to give the OMC the authority to deny, revoke, suspend, or amend any export license held by firms or individuals debarred or suspended from contracting with any federal agency, regardless of whether the acts underlying the debarment or suspension are related to the export control objectives of the ITAR.

Finally, because the new rule fails to provide for prior notice or any other due process safeguards to assure that export licenses are only denied for a valid reason, it also raises serious constitutional concerns.²³

1. No Guidelines for Implementation

In order for a delegation of rule-making power such as that provided to the State Department under the AECA to be valid, the rules promulgated thereunder must provide standards for the agency to follow in exercising its discretion and provide procedural safeguards to assure that the standards are followed properly.²⁴ Because section 126.7(a)(5) lacks such standards or safeguards, the validity of this section, as well as that of the statutory provision which delegated to the OMC the authority to deny license applications, is subject to serious question.

Section 126.7(a)(1), which permits the State Department to deny, revoke, suspend, or amend export licenses whenever it deems such action to be "otherwise advisable," is similarly devoid of any standards to guide the

21. 22 C.F.R. § 126.7(a) (1988).

22. Hearing II, *supra* note 4, at 5 (statement of Sen. Heinz); *see also id.* at 9, 16-17 (colloquy between Joan M. McCabe, National Security and International Affairs Division, GAO, and Sen. Stevens and Sen. Pryor); H.R. Conf. Rep. No. 475, 100th Cong., 1st Sess. 188-89 (1987), *reprinted in* 1987 U.S. Code Cong. & Admin. News 2370, 2449-50.

23. The same concerns apply with equal, if not greater, force to section 126.7(a)(1), which permits the State Department to deny, revoke, suspend, or amend any export license when it "deems such action to be . . . otherwise advisable" 22 C.F.R. § 126.7(a)(1) (1988).

24. *See* 1 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 3:15 (2d ed. 1978).

agency in the exercise of its discretion. Indeed, this new “catch-all” provision, which on its face permits an unlimited scope of action to the State Department, constitutes an even greater usurpation of undelegated and arbitrary authority than section 126.7(a)(5).

Sections 126.7(a)(5) and 126.7(a)(1) contain no standards for application or due process safeguards to assure that exporters are only denied licenses when such denial is consistent with the export policy objectives of the AECA and the ITAR. These sections provide no guidance to the OMC in the use of its discretionary powers against firms or individuals who are debarred or suspended by federal agencies. Without any such guidance, the rule in section 126.7(a)(5) might well result in a draconian *per se* approach, which would result in the denial of licenses to firms or individuals for acts which are not relevant to their qualifications as exporters.

Under current law, contractors may be debarred or suspended for a wide assortment of actual or suspected offenses, many of which have no relationship to the arms export policy objectives underlying the OMC’s licensing authority. For example, government contractors may be deemed ineligible for future contracts because they have a history of unsatisfactory performance of government contracts, or have violated federal or state antitrust statutes relating to the submission of offers.²⁵

Such grounds for suspension or debarment, even when rationally related to the protection of the government’s procurement interests, plainly may lack any relationship to the policy objectives of the arms export licensing process. Since the grounds for suspension or debarment lack this necessary relationship to arms export policy, they provide an inappropriate screening mechanism for determining which contractors should be ineligible to export arms. To the extent that this screening mechanism is an inappropriate means of fulfilling the intentions of the authorizing statute, it is unauthorized and arbitrary.

The regulations governing contractual debarment and suspension normally result in the imputation of acts committed by an individual employee or subsidiary to the entire company, and further provide that debarment or suspension ordinarily applies to all organizational elements of a company.²⁶ This rule may appear useful in those isolated situations where it provides an easy mechanism for the debarment or suspension of an affiliated parent company through the debarment of its subsidiary. However, a subsidiary whose acts result in a contractual debarment or suspension might be essentially unrelated to a sister subsidiary who exports items subject to the ITAR. The new amendments to the ITAR permit the OMC to deny, revoke, suspend, or amend any or all export licenses or applications of that sister company, once the offending affiliate has been debarred, without any guidance or procedures

25. 48 C.F.R. §§ 9.406-07 (1987).

26. *Id.* § 9-406.5.

to ensure that the OMC's actions are mandated by the arms export policies underlying the ITAR.

2. *Inconsistency with Statutory Intent*

Section 126.7(a) is also partially inconsistent on its face with the intent of its authorizing statute, the AECA. Unlike the statute, which only permits the President to deny the application of debarred or suspended contractors for an export license,²⁷ this amendment to the ITAR also permits the OMC to revoke, suspend, or amend existing export licenses.²⁸ To the extent that the revised regulations purport to give the OMC additional powers, not authorized by statute, they are void on their face.²⁹

The power to revoke existing export licenses, and therefore to keep contractors from fulfilling their export contracts, also goes beyond the intended effect of debarment itself. While debarment prohibits contractors from entering into future contracts with the government, contractors are still allowed to fulfill their existing contracts in the absence of specific direction otherwise.³⁰

Furthermore, the authorizing statute and its legislative history provide no indication that Congress intended the OMC to deny export licenses to debarred or suspended contractors without any procedures or safeguards to assure that particular denials have a valid arms export policy basis. The legislative history clearly shows that Congress' principal concern was to assure that the State Department would have the necessary information and authority to permit it to deny licenses to applicants whose conduct shows a history or likelihood of committing violations of export laws and policies.³¹ This legislative history is replete with statements from all interested parties that the new controls to be imposed by the agency should be designed "to make sure that U.S. arms exports conform with U.S. foreign policy interests."³²

It is also clear from the evolution of the authorizing statute that Congress did not intend that the OMC create a *per se* rule denying export licenses to firms or individuals ineligible to contract with the federal government. The pertinent provision was changed from a mandatory requirement, as provided in the original Senate amendment, to a permissive provision in the ultimate statute.³³

27. 22 U.S.C. § 2778(g)(3)(C) (Supp. V 1987).

28. 22 C.F.R. § 126.7(a) (1988).

29. *See, e.g., Meade Township v. Andrus*, 695 F.2d 1006, 1009-10 (6th Cir. 1982).

30. 48 C.F.R. § 9.405-1 (1988).

31. Hearing II, *supra* note 4, at 11-14, 29-36.

32. *Id.* at 5 (statement of Sen. Heinz); *see also id.* at 9, 16-17 (colloquy between Joan M. McCabe, National Security and International Affairs Division, GAO, and Sen. Stevens and Sen. Pryor); H.R. Conf. Rep. No. 475, 100th Cong., 1st Sess. 188-89 (1987), *reprinted in* 1987 U.S. Code Cong. & Admin. News 2370, 2449-50.

33. *Compare* Amendment to S. 1394, § 702(g)(1)(c)(i), 100th Cong., 1st Sess., 133 Cong. Rec. S13,719-20 (daily ed. Oct. 7, 1987), § 702(g)(1)(C)(i) *with* 22 U.S.C. § 2778(g)(3) (Supp. V 1987).

Additionally, members of the Senate committee apparently fully accepted the policy considerations underlying the OMC's licensing functions. The OMC officials who testified before Congress stated that these considerations ensured that "only commercial arms exports that contribute to or are consonant with our foreign policy interests are official[ly] authorized."³⁴ It is significant that no one on the Senate committee suggested that these policy goals should be expanded in any regard. Moreover, State Department witnesses suggested that it would be unfair to deny license applications to companies either when a small group within the company has committed an offense, or when the company is merely indicted for an offense.³⁵ No committee member voiced disagreement with these statements. Instead, the concern expressed by the senators present was that the OMC should have access to information that would provide a "red flag" to identify those applicants which require more careful review.³⁶

4. *Constitutional Concerns with the Link Between Government Contract Debarment and Denial of Export Licenses*

The lack of standards or procedures in sections 126.7(a)(5) and 126.7(a)(1) results in a rule so potentially irrational and arbitrary that it raises constitutional concerns. An elementary precept under the due process clause of the fifth amendment of the U.S. Constitution provides that in enacting any law or regulation, "the means selected shall have a real and substantial relation to the object sought to be attained."³⁷ Pursuant to this principle, the courts have invalidated statutes and regulations in which the relationship between the means selected and the object sought was not sufficiently real or substantial.³⁸

These cases have required the government to provide affected parties with standards or individualized procedures which ensure that the denial of benefits or privileges to each party is in accordance with the objective of the statute or regulation in order for the statute or regulation to withstand constitutional scrutiny. For example, in *Bell v. Burson*,³⁹ a Georgia statute suspended the driver's license of an uninsured motorist involved in an automobile accident unless the motorist posted a bond to cover the full amount of damages claimed against him or her, without regard to the actual

34. Hearing II, *supra*, note 4, at 21 (statement of H. Allen Holmes, Assistant Secretary for Politico-Military Affairs, U.S. State Department).

35. *Id.* at 29 (statements of H. Allen Holmes and Philip Hughes, Deputy Assistant Secretary for Technical Affairs).

36. *See, e.g., id.* at 11-14, 29-36.

37. *Nebbia v. New York*, 291 U.S. 502, 525 (1934).

38. *See, e.g., Dep't of Agric. v. Murry*, 413 U.S. 508 (1973); *Vlandis v. Kline*, 412 U.S. 441 (1973); *Stanley v. Illinois*, 405 U.S. 645 (1972); *Bell v. Burson*, 402 U.S. 535 (1971); *Crawford v. Cushman*, 531 F.2d 1114 (2d Cir. 1976).

39. *Bell v. Burson*, 402 U.S. 535 (1971).

liability of the motorist. Although the Court raised no constitutional objection to the purpose of the statute⁴⁰ (to assure that auto accident victims are compensated), the Court held that the statute denied uninsured motorists due process.⁴¹ The Court found that the state could not terminate an entitlement, such as a driver's license, regardless of whether such an entitlement is considered a "right" or "privilege,"⁴² without a hearing or other individualized procedure to determine whether a reasonable possibility existed that the motorist in question could be liable for the amount of the bond.⁴³

Similarly, under the new ITAR rules, the State Department is able to deny, revoke, suspend or amend the licenses of debarred or suspended contractors, or license holders and applicants for whom the holding of a license is deemed not advisable, without any requirements of notice or procedure.⁴⁴ Such lack of proper procedural safeguards may render these amendments unconstitutional.

There is an inadequate nexus between the grounds sufficient for the suspension or debarment of a contractor from dealing with departments of the U.S. government generally, and the U.S. foreign policy objectives which the OMC is statutorily authorized to enforce by the licensing of arms exporters. Accordingly, section 126.7(a) will not provide due process unless the OMC both provides prior notice to the affected exporter and can show a real and substantial nexus between the facts underlying a suspension or debarment, or other pertinent facts, and the national security and foreign policy objectives of the ITAR and the AECA. Without such procedural safeguards, the constitutional rights of exporters are clearly at risk.

III. PROSPECTS

The linkage between government contract debarment and the denial of arms export privileges, first made in the December 1987 amendments to the AECA and now implemented in the ITAR, is illogical and mistaken. Congress first erred in making its tenuous decision that in any case where a contractor lacks the present responsibility to do business with the U.S. Government, it may *ipso facto* lack trustworthiness as an exporter of arms. The State Department has compounded the error initiated by Congress by providing in the ITAR that a government contract debarment may lead to

40. *Id.* at 542.

41. *Id.* at 543.

42. *Id.* at 539.

43. *Id.* at 540. Of course, constitutional due process requirements apply equally to regulations which affect the ability of firms or individuals to import or export. *Michelin Tire Corp. v. United States*, 469 F. Supp. 270, 286 (Cust. Ct. 1979). Statutes or regulations that involve matters of foreign relations must also have a real and substantial relationship with the objectives they seek to achieve. *Schneider v. Rusk*, 218 F. Supp. 302, 313 (D.D.C. 1963), *rev'd on other grounds*, 377 U.S. 163 (1964).

44. 22 C.F.R. § 126.7(a)(1), (5) (1988).

revocation of existing licenses as well as denial of new ones, and by failing to provide safeguards to ensure that those debarments that lack any foreign policy or national security implications will not result in denial or revocation of export licenses.

Both Congress and the State Department should correct these errors of judgment and policy. In the short term, the State Department should issue standards limiting denial of export privileges for government contract debarments to those situations presenting a clear nexus between the debarment and some foreign policy or national security interest protected by the U.S. export control laws. Government contract debarments that have no "international" dimension should have no adverse consequences for the company's export sales, nor for those of its related companies. To link government contract debarment and export denials on a *per se* basis would be transparently and harshly punitive.

The State Department should also limit its power to the denial of future licenses, not the revocation of existing licenses, at least in cases of government contract debarment. Since the government permits suspended or debarred contractors to complete pending contracts, the contractor's international contracts should not be treated more harshly. Revocation of existing export licenses by reason of government contract debarment could have dire and unfair consequences both for the exporter and for its foreign contracting party—often a foreign government.

In the longer term, Congress should consider reversing its present trend toward a more draconian approach to government contract suspension and debarment. Why should there be any linkage between debarment and loss of export privileges? What legitimate interest does the United States have, beyond an interest in punishing a company for a misdeed that has resulted in a government contract suspension or debarment, in preventing the company from fulfilling or entering into foreign contracts? The Congress might just as logically prohibit a debarred company from doing any business, domestic or foreign, during the period of its debarment, if it is to be arbitrarily prohibited from engaging in foreign business during that period.

At a minimum, Congress should amend the AECA to clearly conform to the Congressional intent that export privileges be denied only where the debarment has some national security or foreign policy dimension.⁴⁵

45. In March 1989, the ABA Section of Public Contract Law submitted a proposal entitled "Proposed ITAR Guidelines Regarding Denial or Revocation of Export Licenses as a Result of Government Contract Debarment or Suspension" to the OMC. These guidelines would limit export license denials based on government contract ineligibility to those instances where contract ineligibility is directly related to the objectives of the AECA, or where the conduct underlying the contract ineligibility poses a substantial risk that the applicant will violate the AECA. Furthermore, the guidelines would limit revocation of existing export licenses based on government contract ineligibility to those cases where the OMC makes a clear showing that continuation of the license would be injurious to U.S. national security or foreign policy interests.