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MEMORANDUM

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SUBJECT: Comments concerning Further Notice of Proposed Rulemaking affecting Limited Reductions in Funding, Suspension, and Special Grant Conditions

The Legal Services Corporation (LSC or the Corporation) Office of Inspector General (OIG) applauds the hard work and serious deliberation evident in the recently published Further Notice of Proposed Rulemaking, 77 Fed. Reg. 46995 (August 7, 2012) (hereinafter "FNPRM"). The OIG continues to support the substance of LSC's proposed regulatory action concerning enforcement mechanisms on the grounds and with the caveats elaborated in its April 2, 2012, Comments and in public statements made before the Operations and Regulations Committee of the LSC Board of Directors. The OIG believes that the structural changes proposed in the FNPRM make the logic of LSC's substantive proposal more apparent, rendering the eventual task of interpreting and applying the rule a more straightforward one. The OIG further believes that the proposed modifications to 45 C.F.R. Part 1618 remedy certain inconsistencies in LSC's existing regulatory structure, bringing Part 1618 into accord with OIG's existing understanding

of when it should consider recourse to enforcement mechanisms. Having analyzed FNRPM in light of its experience with LSC's existing enforcement mechanisms, the OIG endorses the modifications proposed therein and submits the following comments for consideration by the Corporation.

In the OIG's judgment, the reordering of lesser reduction¹ procedures in the FNPRM improves on the treatment of limited reductions in funding in the original Notice of Proposed Rulemaking, 77 Fed. Reg. 4749 (Jan. 31, 2012) (hereinafter "NPRM"), without unwarranted alteration of the substance of the original proposal. The revisions proposed in the FNPRM provide for a more linear presentation of termination and limited reduction procedures, making the procedural similarities and differences of these two enforcement mechanisms more readily apparent. Perhaps more importantly, however, the reorganized version of LSC's proposed rule clarifies the relationship between the standards for termination and the standards for limited reductions. It does so without sacrificing the proportionality that was such an important aspect of the original proposal.

By integrating the proposed limited reduction in funding regulation more fully into Part 1606 and reworking 45 C.F.R. § 1606.3, which formerly spoke only to termination, to include the authorization of and the standard for limited reductions in funding, the FNPRM focuses attention on the position that limited reductions in funding would occupy on the enforcement continuum. Both termination and limited reductions in funding would be available when "there has been a substantial violation by the recipient." Compare 45 C.F.R. § 1606.3(a)(1) (proposed in FNPRM, 77 Fed. Reg. 46995) with 5 C.F.R. § 1606.3(b) (proposed in FNPRM, 77 Fed. Reg. 46995). The

¹ The OIG notes that reductions in funding falling short of termination are referred to in the proposed rule as both "limited reductions in funding", *see, e.g.*, 45 C.F.R. § 1606.3(b), and "lesser reductions in funding," *see, e.g.*, 45 C.F.R. § 1606.7(a)(ii). For the sake of regulatory clarity, LSC should adopt and use only one of these terms in the final regulation.

definition of the term “substantial violation,” in turn, adopts without alteration the familiar five-factor standard currently used in LSC’s existing termination rule. *Compare* 45 C.F.R.

§ 1606.2(h) (proposed in FNPRM, 77 Fed. Reg. 46995) *with* 45 C.F.R. § 1606.3(b). In other words, under the current version of Part 1606, grantees can be terminated outright for any and all violations to which the proposed limited reduction in funding rule would apply if adopted.²

The five-factor standard that would govern both terminations and limited reductions was first formulated and adopted in 1998 with meaningful input from stakeholders. Legal Services Corporation, Termination and Debarment; Recompensation; Denial of Refunding, 63 Fed. Reg. 64636, 64638-39 (Nov. 23, 1998) (hereinafter “Termination Rule”) (discussing substantial changes made to three of the five factors in response to stakeholder comments). The OIG is not aware of any significant discussion of the inadequacy of this five-factor standard as applied to outright termination from the time of its enactment until LSC began to formulate its proposal for limited reductions in funding. It is hard to imagine that the same factors would be less adequate in the context of a more limited monetary sanction, and the OIG does not believe that modification of this standard to make it more restrictive would be consistent with the purpose of the current rulemaking. See NPRM, 77 Fed. Reg. at 4749-50.

By reorganizing Part 1606, the FNPRM is also able to consolidate the proportionality provisions first introduced in the NPRM. *Compare* 45 C.F.R. §§ 1606.3(b), 1606.15(c) (proposed in NPRM, 77 Fed. Reg. 4749) *with* 5 C.F.R. § 1606.3(c) (proposed in FNPRM, 77 Fed. Reg. 46995). As explained in its comments on the NPRM, the OIG believes that the introduction of proportionality into Part 1606 as an explicit consideration represents a significant

² Effectively, the proposed version of Part 1606 would constrain LSC’s recourse to termination by recognizing a group of substantial violations for which termination would not be an appropriate remedy. *See infra* at 3-4 (discussing the role of proportionality in the proposed version of Part 1606). No such limitation exists in the current version of Part 1606.

improvement in the rule. The OIG reads the newly consolidated proportionality provision, 1606.3(c), as being intimately connected with the principal difference between the standard governing application of the termination and the standard for limited reductions in funding. That is, the limited reduction in funding standard differs from the termination standard only insofar as limited reductions are made available where there is a “substantial violation” but “termination, in whole or in part, is not warranted.” 45 C.F.R. § 1606.3(b) (proposed in FNPRM, 77 Fed. Reg. 46995). In contradistinction to the existing rule which appears to recommend termination in whole or in part whenever there has been a “substantial violation,” LSC’s proposed limited reduction rule recognizes that termination may be too harsh a remedy in certain cases, even though those cases involve a “substantial violation.” In other words, on the OIG’s reading, the adoption of the proposed rule concerns not only increased flexibility, an important consideration to be sure, but also greater proportionality in responding to noncompliance, should it occur.³

³ Some in the grantee community have expressed concern that LSC may under some indeterminate future administration apply the longstanding five-factor standard and the new proportionality requirement in an arbitrary manner, but the OIG does not believe that further procedural changes to bolster the limited reduction in funding standard would be warranted or effective. The OIG does not believe that it is appropriate to presume bad faith on the part of the Corporation. Moreover, the OIG is concerned that the introduction of additional factors into a rule that already contains a five-factor standard and a proportionality requirement would do little to deter some hypothetically abusive future administration from arbitrarily applying regulatory standards. The addition of such factors would, however, make for a more cumbersome rule, a result at odds with purpose of the current rulemaking. *See* NPRM, 77 Fed. Reg. at 4749-50 (“LSC is now considering adding enforcement tools to increase LSC’s flexibility in addressing compliance issues.”).

One feasible remedy for the concern expressed by the field would be publication of all “final decisions” made under Part 1606, whether those decisions be “modify, withdraw, or affirm the preliminary determination” 5 C.F.R. § 1606.7(e) (proposed in FNPRM, 77 Fed. Reg. 46995). Such publication would subject LSC’s application of Part 1606 to public scrutiny, allow grantees to determine whether they are receiving equal treatment under the rule, and build a body of decisional guidance for other grantees. The OIG believes that a procedural change to require publication of decisions could go a long way to alleviating any perceived risk of arbitrariness in the proposed limited reduction in funding rule.

One procedural change highlighted for comment in the FNPRM is the introduction of an appeal to the President for limited reductions in funding. FNPRM, 77 Fed. Reg. at 46997. Provided that the process by and timeline within which such an appeal is taken remain streamlined, the OIG does not believe that this additional procedural step would render the new limited reduction in funding mechanism unworkable. As currently written, the circumscribed appeal right described in 45 C.F.R. § 1606.10 (proposed in FNPRM, 77 Fed. Reg. 46995), by itself, is not likely to generate the sort of protracted process that would deter legitimate recourse to the new limited reductions in funding mechanism, and so, the OIG can support its inclusion in the proposed rule.

Still, the OIG would caution against the addition of an array of procedural wrinkles, which in isolation may not threaten the efficient application of the proposed rule but taken together could, contrary to the intention of the current rulemaking, create a new cumbersome, resource intensive enforcement process. The OIG believes that all procedural modifications to the regulatory proposal in the NPRM should be evaluated in light of the original purpose of the proposed regulatory action, namely to provide LSC with more flexible alternatives to its existing enforcement mechanisms, thereby enabling it to respond more effectively to instances of non-compliance. NPRM, 77 Fed. Reg. at 4749-50.

The FNPRM also includes welcome revisions to outdated language in 45 C.F.R. Part 1618, which does not appear to have been substantively modified since its adoption as a final rule in 1976. Legal Services Corporation, Part 1618—Enforcement Procedures, 41 Fed. Reg. 51604 (Nov. 23, 1976). Much has changed in the laws and regulations governing LSC's grant making activities since 1976, including the imposition of significant restrictions in the Omnibus Consolidated Recessions and Appropriations Act of 1996 and subsequent appropriations acts.

Indeed, in the years since 1976, a conflict has developed between the text of Part 1618, on the one hand, and 45 C.F.R. Parts 1606 and 1623, on the other. Whereas Part 1618 only speaks to enforcement in cases where the LSC Act or LSC-issued “rules and regulations” have been violated, later enacted Parts 1606 and 1623 make enforcement mechanisms available for violations of “the LSC Act, the Corporation’s appropriations act or other laws applicable to LSC funds, or Corporation rule, regulation, guideline or instruction, or a term or condition of the recipient’s grant or contract.” Compare 45 C.F.R. §§ 1618.2, 1618.5(b) with 45 C.F.R. § 1606.3(a)(1); see 45 C.F.R. § 1623.3(a) (making suspension available where there has been a substantial violation “of an applicable provision of law, or a rule, regulation, guideline, or instruction issued by the Corporation, or a term or condition of the recipient’s current grant or contract.”). The OIG believes that the new definitions proposed in the FNPRM, 45 C.F.R. § 1618.2, and the use of the newly defined terms in the proposed text of 45 C.F.R. § 1618.5(a) and (b) bring Part 1618 into accord with Parts 1606 and 1623. See 45 C.F.R Part 1618 (proposed in FNPRM, 77 Fed. Reg. 46995). Moreover, the OIG believes that these amendments are consistent with the reading that has, in practice, been given to the existing text of Part 1618 for some time. Accordingly, the OIG is pleased to endorse these proposed modifications of Part 1618.

In connection with Part 1618, the OIG agrees with the statement in the FNPRM that “[i]nformal resolution includes remedial actions, preventative actions, and sanctions.” FNPRM, 77 Fed. Reg. at 46999. It, accordingly, endorses the proposed interpretation of Part 1618 pursuant to which formal enforcement mechanisms would be available to LSC where a grantee has engaged in a substantial violation but will not agree to informal sanctions. *Id.* The OIG is concerned, however, that the hypothetical case used by the FNPRM to illustrate this

interpretation suggests a misreading of Part 1618 in one important respect. *Id.* While it is certainly possible to apply LSC's enforcement mechanisms where a grantee has "persistently and intentionally" violated a regulation, a violation that gives rise to enforcement proceedings need not be *both* persistent *and* intentional. Both the existing and proposed text of 45 C.F.R. § 1618.5(b) refer to grantees that have "persistently *or* intentionally" violated an operative requirement (emphasis added). Thus, a single intentional violation would be sufficient to satisfy the procedural threshold established by 1618(b) even if it were not persistent.

What is perhaps more, there is a meaningful distinction between intentional violations and "knowing and willful" violations. The five-factor standard used in the existing termination rule and the proposed limited reduction in funding rule directs the Corporation to consider whether a violation was "knowing and willful" when deciding whether to impose those remedies. 45 C.F.R. § 1606.3(b)(5); 45 C.F.R. § 1606.2(h) (proposed in FNPRM, 77 Fed. Reg. 46995). In its final publication of the Part 1606 as it now stands, LSC distinguished between "intentional" and "knowing and willful" conduct. At the time, the proposed version of the five-factor standard had included consideration of whether the violation in question was intentional, but the Corporation modified the standard in its final publication, giving it its current form, which refers to "knowing and willful" violations. Termination Rule, 63 Fed. Reg. at 64638. The Corporation also defined "knowing and willful" in the final rule to mean "that the recipient had actual knowledge of the fact that its action or lack thereof constituted a violation and despite such knowledge, undertook or failed to undertake the action." 45 C.F.R. § 1606.2(b); Termination Rule, 63 Fed. Reg. at 64637. As the OIG reads this regulatory history, LSC was drawing a clear distinction between intentional violations, on the one hand, and knowing and willful violations, on the other. It appears that the Corporation understands intentional violations to occur when a

person or entity subject to a rule undertakes some action on purpose and that action violates the rule. Knowing and willful violations require more, namely, the actor must purposely undertake an action with knowledge that it violates the rule.

Neither the current version of Part 1618 nor the proposed revisions to that part require such knowledge, and, given the role of Part 1618 in LSC's enforcement regime, they should not. 45 C.F.R. § 1618.5 largely serves to establish a threshold or minimum requirement for recourse to certain enforcement mechanisms. It describes the circumstances under which LSC will consider termination, suspension, and, under the proposed version, limited reductions in funding. It does not set out the substantive standards by which LSC will decide whether or not to actually impose those remedies. Those standards are contained in the rules that deal directly with the remedies under consideration. In the OIG's judgment, it would be a mistake to set the threshold so high that it forestalls thorough consideration of the five-factor standard in Parts 1606 and 1623 in cases where some or all of those factors may be present. As a practical matter, if the threshold in 45 C.F.R. 1618.5(b) were set higher, it would make the fifth factor, "whether the violation as knowing and willful," in the five-factor standard superfluous because that factor would automatically be present every time the threshold requirement in Part 1618 was satisfied. 45 C.F.R. § 1606.3(b); 45 C.F.R. § 1623.3(b). In the OIG's judgment, the threshold function of 45 C.F.R. 1618.5 is best maintained by preserving its reference to "persistent or intentional" violations, leaving consideration of whether particular violations were "knowing and willful" to the application of Parts 1606 and 1623.

The OIG thanks the Board of Directors for the opportunity to submit the foregoing comments concerning LSC's revised regulatory proposals for amendment of 45 C.F.R. Parts 1606 and 1618. The OIG appreciates that the Board of Directors, the Operations and

Regulations Committee, and LSC Management have given much consideration to the regulatory proposals presented in the NPRM and FNPRM and to comments received from the grantee community. The OIG remains supportive of LSC's regulatory efforts pertaining to alternative enforcement mechanisms and is hopeful that its comments will assist the Corporation as it moves forward with its rulemaking. Subject to the reservations stated in its original comments and with the clarifications discussed above, the OIG recommends adoption of the regulations proposed in the NPRM, 77 Fed Reg. at 4752-54, as modified in the FNPRM, 77 Fed. Reg. at 47000-03.