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OFFICE OF LEGAL AFFAIRS

RULEMAKING OPTIONS PAPER

TO: Operations & Regulations Committee

DATE: October 5, 2010

SUBJECT: Rulemaking Options Paper – 45 CFR Part 1609 – Fee-Generating Cases; 45 CFR Part 1610 – Use of Non-LSC Funds; Program Integrity

The Office of Legal Affairs (OLA) has recently become aware of an ambiguity, and apparently unintentional inconsistency in the LSC regulation governing the limitations on and procedures for LSC recipients providing representation in fee-generating cases. Due to the significance of the consequences of this ambiguity, the Committee and the Board may wish to address this issue and amend the regulation to provide clarification. This Rulemaking Options Paper (ROP) has been prepared to assist the Committee and Board in its deliberations and decision making on this matter.

Background

During a site visit to an LSC recipient, the Office of Compliance and Enforcement (OCE) noted that the recipient's operations manual provided that Part 1609 regarding fee-generating cases did not apply to cases funded with available public non-LSC funds.[1] Although Part 1609 appears on its face to apply to all recipient activities regardless of funding source, the recipient pointed out that §1610.2(a) explicitly lists Part 1609 as one of the "LSC Act" restrictions that do not apply to the use of public non-LSC funds. 45 C.F.R Part 1610.4(b). OCE referred the question to the Office of Legal Affairs (OLA).

Generally, the substantive LSC restrictions on LSC recipients fall into two categories: "entity restrictions" and "LSC funds restrictions." "Entity restrictions" apply to all activities of a recipient regardless of the funding source (except for the use of tribal funds as intended). Most entity restrictions originate from the FY 1996 LSC appropriations riders. In contrast, "LSC funds restrictions" usually originate from the LSC Act and apply to the use of LSC funds and private funds, but not to tribal or public non-LSC funds used as intended. These are often

[1] In this ROP, any reference to public non-LSC funds or tribal funds includes only such funds that are used "in accordance with the purposes for which [those other funds] are provided . . . ." as per §1010(c) of the LSC Act. 42 U.S.C. §2996i(c). IOLTA funds are considered public funds for these purposes. 45 C.F.R. §1610.2(f). Section 1010(c) applies the LSC Act's restrictions to all non-LSC funds (private or public) with this exception. Thus the Act's restrictions are referred to herein as applying to LSC and private funds for convenience, assuming that no tribal or other public funds are used contrary to the purposes for which they were provided.

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referred to as "LSC funds restrictions," "Corporation funds restrictions" or "LSC Act restrictions."[2]

Part 1609 is based on §1007(b)(1) of the LSC Act, which provides that "no funds made available by the Corporation . . . may be used—(1) to provide legal assistance [except as per LSC regulation] with respect to any fee-generating case . . . ." As such, the fee-generating case provision of the LSC Act is an "LSC funds restriction". However, §1609.3, as currently drafted, is not limited to the use of LSC funds. Rather it reads as an "entity restriction" reaching all of an LSC recipient's funds:

> (a) Except as provided in paragraph (b) of this section, a recipient may not provide legal assistance in a fee-generating case unless:
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> > (1) The case has been rejected by the local lawyer referral service, or by two private attorneys; or
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> > (2) Neither the referral service nor two private attorneys will consider the case without payment of a consultation fee.
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> (b) A recipient may provide legal assistance in a fee-generating case without first attempting to refer the case pursuant to paragraph (a) of this section only when: [additional exceptions for certain statutory benefits cases, emergencies, cases without substantial fees and damages, and cases in which the private bar can be shown to not be interested.]

This language follows the same structure as other entity restrictions such as Part 1617—Class Actions, which states at §1617.3 that "Recipients are prohibited from initiating or participating in any class action."

In contrast, §1610.2(3), which was revised contemporaneously with Part 1609, lists Part 1609 as an LSC Act restriction and not an entity restriction. Part 1610 categorizes the substantive LSC restrictions as either "LSC Act restrictions" based on the provisions of the LSC Act or "entity restrictions" based on the restrictions in §504 of the 1996 LSC appropriation (referred to in Part 1610 as "Section 504 restrictions").[3] Section 1610.3 provides a general prohibition regarding the use of non-LSC funds:

> A recipient may not use non-LSC funds for any purpose prohibited by the LSC Act or for any activity prohibited by or inconsistent with Section 504, unless such use is authorized by §§1610.4, 1610.6 or 1610.7 of this part.

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[2] Referring to these as "LSC Act" restrictions is somewhat of a misnomer in that some of the restrictions in the LSC Act are entity restrictions on all funds and LSC has at times imposed restrictions on recipients' LSC and private funds that do not appear in the LSC Act. Nonetheless, it is the term used by Part 1610.

[3] The assisted suicide restriction was enacted by Congress subsequent the drafting of these provisions of Part 1610. It is an amendment to the LSC Act and LSC implemented it at 45 C.F.R. Part 1643. While is it not listed in Part 1610, it would be in the category of LSC Act restrictions.

Section 1610.4(a) provides a tribal funds exception to the substantive restrictions. Section 1610.4(b) provides a public non-LSC funds exception to the LSC Act restrictions but not the Section 504 entity restrictions: "A recipient may receive public or IOLTA funds and use them in accordance with the specific purposes for which they were provided, if the funds are not used for any activity prohibited by or inconsistent with Section 504." Thus §1610.4(b) permits the use of public non-LSC or IOLTA funds for all activities categorized as "LSC Act restrictions" in §1610.2, which includes Part 1609. This creates a conflict between the language of Part 1610 and Part 1609.[4]

Generally Part 1610 works in tandem with the other regulations. Each regulation expressly specifies whether it applies to LSC funds (usually referred to as "Corporation funds") or if it applies to the recipient entirely. Part 1610 then provides the tribal funds exception at §1610.4(a) (which is not mentioned in the other regulations) and applies the other regulations to the use of private funds at §1610.4(c) (which is not mentioned in the regulations that apply themselves only to "Corporation funds").[5] The tribal funds exception and the private funds coverage apply uniformly to all restrictions. Normally the exception for public non-LSC funds only applies to regulations that themselves are limited to LSC funds and private funds. Part 1609 is an anomaly in that it uses "entity" language to apply to the use of all funds, but is treated by Part 1610 as an "LSC Act" restriction that does not apply to public non-LSC funds.

Furthermore, the LSC Compliance Supplement, which provides guidance to auditors regarding recipient compliance with the substantive LSC restrictions, states that Part 1609 means that "[r]ecipients may not use Corporation or private funds to provide legal assistance in a fee-generating case unless" one of the regulatory exceptions applies. It does not tell auditors to read Part 1609 as applying to tribal or public non-LSC funds. The Compliance Supplement was last revised in December 1998 (after both Parts 1609 and 1610 had been updated).

Reviewing the regulatory history for Part 1609, and the changes in 1996 and 1997, does not resolve this conflict, but it sheds some light on how it might have arisen. From inception in 1976 through 1996 Part 1609 followed the language of the LSC Act and only applied to "Corporation funds" and private funds as per §1010(c). At that time §1609.3 provided that: "[n]o recipient shall use *funds received from the Corporation* to provide legal assistance in a fee-generating case unless" one of the regulatory exceptions applied. 41 Fed. Reg. 18528 (proposed rule May 5, 1976), 41 Fed. Reg 38505 (final rule Sept. 10, 1976), and 49 Fed. Reg. 19656 (final rule May 9, 1984) (the last final rule prior to 1996) (emphasis added). *See* Regulations Publication History: Part 1609: Fee-generating cases at http://www.lsc.gov/laws/regulationshistory1609.php (visited June 21, 2010).

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[4] Parts 1609 and 1610 were revised contemporaneously in 1996 and 1997. Parts 1609 and 1610 were issued as interim rules on August 29, 1996. 61 Fed. Reg. 45765 (Part 1609) and 61 Fed. Reg. 45740 (Part 1610). Part 1609 had the revised language while Part 1610 treated it as an LSC Act restriction. Part 1610 was finalized on December 2, 1996, but then revised again on March 14, 1997, and finalized on May 21, 1997. 61 Fed. Reg. 63749, 62 Fed. Reg. 12101 and 62 Fed. Reg. 27695. Part 1609 was finalized on April 21, 1997, with the revised language, while Part 1610 was still under revision. 62 Fed. Reg. 19398.

[5] Section 1610.4(c) works in tandem with the regulations based on the LSC Act by applying them to the use of private funds as per the requirements of §1010(c) of the LSC Act as described in footnote 1.

In 1996 LSC revised Part 1609 in conjunction with the enactment of the Part 1642 entity prohibition on recipients claiming or collecting and retaining attorneys' fees. In the revision the language was changed from the prior "Corporation funds" prohibition to the more general "no recipient" entity prohibition. Notably though, there is no discussion in the preamble to the proposed or final regulation of this significant substantive change in scope. 61 Fed. Reg. 45765 (proposed rule August 29, 1996) and 62 Fed. Reg. 19398 (final rule April 21, 1997). Nor is there any such discussion in any of the relevant LSC Board transcripts.[6] Rather, the only mention of the change in language is the following discussion of the revised §1609.3:

> This section defines the limits within which recipients may undertake fee-generating cases. This new section reorganizes and replaces §§1609.3 and 1609.4 of the current rule *in order to make them easier to understand*.

Id. (appearing in the preambles to both the proposed and final rules) (emphasis added). The regulatory history contains extensive discussions of policy and regulatory nuances regarding the new attorneys' fees provisions and their relationship with Part 1609. These discussions involved LSC management, the LSC OIG and representatives of recipients.[7] Considering the attention paid to this and the other regulations implemented in 1996 and 1997, it seems very unusual that LSC would adopt such a substantial substantive change to Part 1609 without any discussion or any description of the change in the preamble to the rule.

In sum, parts 1609 and 1610 are in direct conflict regarding the scope of Part 1609. Section 1609.3 would apply it to the use of all funds, but Part 1610 creates exceptions for both tribal and public non-LSC funds. While the tribal funds exception applies uniformly to all regulations, the public non-LSC funds exception normally does not apply to regulations that would themselves apply to all funds. While the language of Part 1609 changed in 1996 from a restriction on LSC funds to a restriction on all funds, the preamble to the rule indicates that substantive changes were not intended. The conflicts with Part 1610, issued contemporaneously, and the subsequent LSC Compliance Supplement further demonstrate that the scope of Part 1609 is not clear from the regulations themselves.

Options

There are different options the Committee may consider to resolve the ambiguity created by the conflict in the language of the regulations. Which option the Committee may select will depend in large measure on what policy position the Committee determines to recommend. If the Committee believes that the fee-generating case requirements should attach only to LSC and other private non-LSC funds as provided in the LSC Act and as reflected in Part 1610, the approach would be to amend Part 1609 to clarify its language. If the Committee believes that the

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[6] At the time LSC was engaging in a flurry of activity enacting regulations implementing the new 1996 restrictions. Additionally LSC was working with a reduced staff having just lost one-third of its funding.

[7] CLASP has stated that it was not aware of any intent to make this change to Part 1609, and that since 1996 CLASP has treated Part 1609 as not applying to public non-LSC funds and believes that is the same as the general understanding of LSC recipients.

fee-generating case requirements should extend to all funds of a recipient, the approach would be to amend Part 1610 to resolve the conflict between Parts 1609 and 1610. Alternatively, the Committee could choose to not amend either regulation at this time and allow Management to resolve the apparent conflict through the exercise of its enforcement discretion. These options are discussed in further detail below.

Option 1 – Recommend to the Board that the Board initiate a rulemaking to amend the fee-generating relation at Part 1609 to clarify that the fee-generating case restrictions and requirements does not apply to cases supported in whole by public non-LSC funds or tribal funds (provided those funds are being used as intended), but rather applies only to cases supported in whole or part with LSC or private non-LSC funds.

A substantial argument can be made that the 1997 change to the language of Part 1609 appearing to extend the scope of the fee-generating case restrictions beyond LSC and private non-LSC funds to be an entity restriction was not intended, but, was a mistake made in the attempt to "simplify" the language of the regulation without any substantive change to the meaning of the regulation. This argument finds its basis in various indicia discussed above, such as the preamble to the final rule amending Part 1609; the clear scope of the language in the LSC Act, the reference to Part 1609 in Part 1610, the treatment of the issue in the LSC compliance supplement. To the extent this is the case, unless the Committee wishes to adopt a stricter policy position, the Committee could recommend to the Board that LSC initiate a rulemaking to amend the language of Part 1609 to clarify that it is reaches only LSC and private non-LSC funds.

The advantage of following this approach is that it would be consistent with the provisions of the LSC Act (and not inconsistent with anything in the applicable appropriations acts). Moreover, it would resolve the conflict between Parts 1609 and 1610 and would appear to reflect the intention of the Corporation in 1997 to not make a substantive change to the previously existing scope of the regulation. In addition, amending 1609 in this way would be consistent with the existing LSC guidance and practice. As noted above, the LSC Compliance Supplement guidance to auditors does not instruct them to apply the restrictions to a recipient's public non-LSC funds and to our knowledge the auditors have not been reporting instances of a recipients use of public non-LSC funds as problematic with respect to the regulation. Further, prior to raising the question most recently with OLA, OCE's practice has not been to apply the restriction to a recipient's public non-LSC funds. Finally, to our knowledge, the general understanding and practice in the field has been that the restriction does not apply to a recipient's public non-LSC funds. Thus, it would appear that amending Part 1609 to clarify that it applies as an restriction on LSC and private non-LSC funds, rather than as an entity restriction, would not create any substantive change from current practice.

The main apparent disadvantage to this approach would be whether such a move would be seen to be encouraging recipients to seek out fee-generating cases. However, the current understanding and practice is generally that the restriction does not apply to public non-LSC funds, and we are not aware that recipients are using such funds in any significant measure to undertake fee-generating cases that would otherwise be taken by the private bar. Thus, it seems unlikely that a clarification of the regulation which bring it into accord with the prior language and the current practice would appear to encourage or increase the incidence of recipients' taking fee-generating cases. Moreover, recipients are subject, as entities, to the priorities rule (45 CFR Part 1620) which requires recipients to provide legal assistance (regardless of the source of funds used for such legal assistance) only in accordance with adopted priorities and the types of cases that the fee-generating case restriction would prohibit are generally not within any recipient's priorities.

Another potential disadvantage to this approach is that it is arguably more complex in administration, in that there if the restriction is applied only to LSC and private non-LSC funds, and a recipient takes fee-generating cases with available public non-LSC funds (without otherwise meeting the criteria and procedural requirements of the regulation) the recipient will have to keep sufficient records to demonstrate the segregated and proper use of the funds. However, this is true for all of the LSC Act-only restrictions and tracking and documentation of proper uses of various sources of funds has not, to date, proven to be an insurmountable barrier to effective administration or oversight. Moreover, the flexibility afforded to recipients may be argued to outweigh any complexity in recordkeeping occasioned by the application of the restriction to the source of funds rather than as an entity restriction.

Option 2 – Recommend that the Board initiate a rulemaking to amend Part 1610 to change the reference to Part 1609 as a restriction applying only to LSC and private non-LSC funds and expressly categorize it as an entity restriction.

If the Committee believes that as a matter of policy, the fee-generating case restriction should be applied as an entity restriction rather than as a restriction on a recipient's LSC and private non-LSC funds, then the current wording of Part 1609 would not need to be changed and the inconsistency could be rectified by amending Part 1610. This approach would reflect a policy choice by the Committee that the amendment in 1997 was intended to broaden the scope of the restriction and/or notwithstanding the intention of the Board in 1997, such a broadened scope is appropriate at the current time.

The main advantage of this approach would appear to be that it would send a clear signal that the Corporation thinks that recipients should not be using their scarce resources, regardless of source, on cases which would otherwise be taken by the private bar. Even if the restriction were applied to public non-LSC funds, recipients could still take fee-generating cases under certain circumstances (all of which are designed to ensure that cases which are likely to be taken by a private attorney are and that recipients focus on cases in which private representation is not otherwise available). Moreover, as noted above, the types of typically fee-generating cases are generally not the sort of cases within most recipients' priorities. As such, although it could be a substantive change for recipients, it is unclear that it would have a major effect on their case loads.

There are, however, disadvantages to this approach. First, there is no statutory requirement extending the funds restriction in the Act to the entity. In the 1996 restrictions, Congress extended some previously existing Act (funds) restrictions and made them entity restrictions (e.g., lobbying restrictions). The fee-generating case restriction, however, was not so extended and there is no indication that there is any Congressional intent that the fee-generating case restriction be applied as an entity restriction to all of a recipient's funds. As such, expressly extending the restriction may be viewed as unnecessary and unwarranted to effectuate Congress' intent with respect to this issue. This may particularly be true in light of Congress' repeal of the statutory ban on the claiming, collection and retention of attorneys' fees. In explaining this change Congress acknowledged that there are cases in which a recipient may be able to obtain fees and, in such cases, should be able to reap the benefit of such fees. Conference Report 111-366 (December 8, 2009) at 769.

Second, express application of the fee-generating case restriction would appear to effect a substantive change in LSC and field understanding and practice. As such, we may expect opposition from the field. Even if the actual cases which recipients undertake would not be much different either way, extension of the rule would impose additional procedural and administrative requirements on recipients and would create additional compliance and enforcement duties for LSC staff. A valid argument could be raised that there does not seem to be a problem stemming from the current general understanding and practice. That is, to the extent that recipients have been using available public non-LSC funds to support fee-generating cases over the last 13 years, such activities have not been a source of concern that recipients are misusing their resources or providing undue and inappropriate competition with the private bar. As such, there is an argument that there is no "problem" in need of this particular "solution."

Finally, amending Part 1610 to expressly extend the fee-generating case restriction to public non-LSC funds would create a bit of an anomaly in the structure of Part 1610. Part 1610 currently groups restrictions into the two statutory categories – entity restrictions found in the appropriations act (and the implementing regulations) and the funds restrictions found in the LSC Act (and implementing regulations). The change contemplate by this option would create a new category, with one member – an LSC Act-only restriction applied as an entity restriction. Certainly, this could be accomplished, but without a compelling policy reason it may be that creating this one anomalous situation within 1610 would be unnecessarily confusing and regulatorily inelegant.

Procedural Options For Rulemaking

As both Options 1 and 2 involve potential rulemaking, before turning to Option 3, it is appropriate at this juncture to provide some information on procedural options, should the Committee wish to recommend initiation of rulemaking.

If the Committee recommends initiation of rulemaking, the Board can also recommend the appropriate rulemaking process. Under the standard procedure for Rulemaking under the LSC Rulemaking Protocol, after determining to initiate a rulemaking Staff would be directed to develop a Notice of Proposed Rulemaking (NPRM) consistent with any policy guidance provided by the Board in consideration of the various policy concerns and options set forth herein, management's recommendations and comments from the field and other interested members of the public. An NPRM could be developed and the Committee and the Board could meet at the next regularly scheduled meeting in January to approve the NPRM for publication (or sooner, at the Committee's and Board's option). After a comment period (typically 30 days), a Draft Final Rule would be prepared and the Committee and Board could take up a Draft Final Rule a later meeting.

As an additional option, Committee could recommend that the Board include in its instructions a direction that a fact-gathering regulatory workshop be convened to discuss the policy choices and issues involved. Convening a regulatory workshop would allow for more informal consultation between LSC and interested parties before the development of an NPRM, but would also likely require additional time, delaying the consideration and adoption of a final rule. It is unclear whether a fact-gathering workshop in this instance would help develop a factual record beyond that which could be produced through the standard notice and comment process.

Alternatively, the Committee could recommend that the Board initiate a rulemaking and direct that it be conducted as a negotiated rulemaking. However, negotiated rulemakings are time, labor and cost-intensive and generally reserved for issues where one is looking to make significant changes involving complex issues where a series of face-to-face negotiations will likely help the agency and the interested parties involved in the negotiation consider and work through a number of difficult factual and policy problems. Moreover, once the negotiated rulemaking is completed, LSC would still have to conduct a standard notice and comment rulemaking. The situation at hand does not appear to be a good candidate for a negotiated rulemaking.

Finally, yet another option would be recommend that the Board initiate a rulemaking and direct Staff to develop and publish for comment an Advance Notice of Proposed Rulemaking (ANPRM). This action would be most appropriate if the Board wanted to resolve the conflict between the regulations, but was conflicted or felt that it did not have enough information to have a policy direction in mind to propose and wanted a formal, public way to obtain additional, broader input. An ANPRM often does not set forth specific proposed regulatory text changes, but instead often sets forth questions and policy options upon which it seeks comment that the agency may formally take under consideration. After receiving comment on an ANPRM, the Board would decide whether to proceed with the rulemaking and provide policy guidance for the development of an NPRM or whether to close the rulemaking without any further action. The advantage of this course is that is allows for additional input at the early stages of the Board's consideration of possible regulatory amendment. The disadvantage is that it does take longer than a traditional notice and comment rulemaking. However, in this case, since there is no statutory deadline against which LSC is working, taking additional time does not appear to present a significant problem. There is also a question of whether an ANPRM would be particularly efficacious in this situation. That is, in this case the policy alternatives would appear to be fairly stark and it may be that an ANPRM is better suited to situations involving more nuanced choices.

Option 3 – Recommend against any rulemaking.

The Committee could, in the alternative, recommend against any rulemaking and let the ambiguity caused by the conflict in the regulations to persist. In pursuing this option the Committee could leave the matter in the hands of Management to make a enforcement discretion policy decision about how to apply the regulations.

The main advantage in this approach is that it requires no further rulemaking action. As noted above, this ambiguity and conflict have existed for 13 years without creating a particular problem in practice. Thus, it may be argued that there is no pressing need to resolve the conflict, particularly as Management could adopt an enforcement policy as a matter of discretion to provide clarity on the policy it will follow. Under this approach rulemaking at some future date would not be precluded.

The main disadvantage to this approach is that it involves purposefully perpetuating a conflict in the regulations and the ambiguity that comes from it. Having had the conflict brought to the fore, an argument can be made that the Corporation should not have regulations that conflict and has a responsibility to remedy such situations. Having clear, consistent regulations benefits both recipients and the Corporation, both by making application and oversight simpler, and also by creating a situation in which Congress and the public can be confident in the administration of the national legal services program.