OMB Announces Best Practices for Regulatory Enforcement and Adjudication

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If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

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On August 31, 2020, the Office of Information and Regulatory Affairs (OIRA), within the Office of Management and Budget (OMB), issued a memorandum to all executive departments and agencies on reforming regulatory enforcement and adjudication. The memorandum implements Executive Order 13924, "Regulatory Relief To Support Economic Recovery" (Executive Order), which President Donald Trump signed on May 19, 2020. The Executive Order articulates "the policy of the United States to combat the economic consequences of COVID-19" by, among other things, "committing to fairness in administrative enforcement and adjudication." In particular, Section 6 of the Executive Order directs agencies to consider certain "principles of fairness" in administrative enforcement and adjudication, and revise their procedures and practices in light of them, consistent with applicable law.

The Executive Order sets forth a list of 10 such principles for consideration by the agencies and tasks OMB with issuing guidance on its implementation. Pursuant to this directive, the memorandum announces "best practices" and recommendations for agencies to ensure fairness in administrative enforcement and adjudication. To the extent the principles require agencies to "revise their practices and procedures," the agencies should coordinate with OIRA staff to issue any needed final rules, wherever possible, by November 26, 2020 (absent a waiver granted by the OIRA administrator), "with a request for public comment that agencies may consider in any future revisions."

The memorandum has the potential to affect the way that enforcement agencies including the Department of Justice (DOJ), Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), Office of Foreign Assets Control (OFAC) and Financial Crimes Enforcement Network (FinCEN) approach investigative and enforcement decisions. The Executive Order and memorandum reflect a preference for leniency and a desire to ease the economic burdens placed on companies when responding to the investigative and enforcement activities of these agencies. Taken together, the Executive Order's "principles" and the memorandum's best practices may establish a higher bar for agencies looking to bring enforcement actions against regulated entities.

The memorandum's best practices expand on the 10 principles articulated in the Executive Order and can generally be grouped into the following categories:

Liability, Imposition of Penalties and Duration of Investigations

> **"Liability should be imposed only for violations of statutes or duly issued regulations, after notice and an opportunity to respond."**

- **Initiating an Investigation.** In initiating an investigation or enforcement action, the agency should provide the target party with a citation to the statute and regulation that it asserts has been violated, and must provide an explanation of how the asserted conduct is prohibited under such statute or regulation.
- **Notice and Opportunity To Respond.** Agencies should review their procedures to ensure that liability is not imposed prior to the target party receiving notice and being afforded an opportunity to respond.

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- **Criminal Referrals.** The memorandum also states that information or materials obtained in an administrative investigation or enforcement action should only be referred to the DOJ (or other relevant criminal investigation or enforcement authority) for criminal investigation "in a manner that is consistent with the law and with best practices as established by policies, procedures, and guidelines regarding parallel investigations."

"Penalties should be proportionate, transparent, and imposed in adherence to consistent standards and only as authorized by law."

- **Transparency in Enforcement.** The memorandum states that agencies should make information regarding enforcement decisions and penalties available to the public, and permit private parties to disseminate information about their cases.
- **Proportionality and Duration of Enforcement Actions.** The memorandum also discourages "decade(s)-long settlements that are disproportionate to the violation(s) of law." It recommends that agencies adopt expiration dates and termination criteria for consent orders, consent decrees and settlements.
- **Steps To Encourage Voluntary Self-Reporting.** Agencies should also establish procedures to encourage voluntary self-reporting of regulatory violations by regulated parties in exchange for reductions or waivers of civil penalties.
- **Declination of Enforcement.** The memorandum also advises that an agency should decline enforcement, or the imposition of a penalty, when the agency determines that the regulated party attempted in good faith to comply with the law.

"Administrative enforcement should be prompt and fair."

- **Duration of Investigation.** The memorandum states that "[a]gency regulations should apply limiting principles to the duration of investigations." Investigating staff should be required to either recommend or bring an enforcement action, or otherwise cease the investigation, within a defined time period after its commencement, absent a showing of unusual circumstances. Parties under investigation should be informed by the agency upon the agency closing its investigation or making no finding of violation. The memorandum also recommends that agencies consider and adopt estoppel and *res judicata* principles to eliminate multiple enforcement actions for a single body of facts.

For example, SEC and CFTC enforcement staff often take years to complete their investigations and regularly request that parties sign agreements to toll the applicable statutes of limitations, often with multiple extensions. OMB's updated guidance, if followed, could significantly curtail these practices.

Additionally, when the CFTC closes an investigation, it often does so without informing the subject of the investigation, leaving individuals and companies with the challenge of dealing with the unknown. This includes compliance with disclosure obligations as the subject of an investigation and continuing to spend time and resources preparing for enforcement actions that will never occur. While the CFTC does have a policy that gives enforcement staff discretion, upon request and for other reasons, to advise a party that an investigation has been closed, OMB's guidance would require the CFTC to "inform the party when the investigation is closed." The SEC already has a policy of notifying individuals and entities when the staff has determined not to recommend an enforcement action against them, so the OMB guidance is less likely to impact the SEC staff's practices in this regard.

Burden of Proof and Evidentiary Standards

"The Government should bear the burden of proving an alleged violation of law; the subject of enforcement should not bear the burden of proving compliance."

- **Burden of Proof.** The memorandum reiterates "that agencies should review their procedures to ensure that members of the public are not required to prove a negative to prevent liability and enforcement consequences."
- **Rule of Lenity.** Agencies are also advised to consider applying the rule of lenity to investigations, enforcement actions and adjudications by interpreting statutory or regulatory ambiguities in favor of the target party.

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"Consistent with any executive branch confidentiality interests, the Government should provide favorable relevant evidence in possession of the agency to the subject of an administrative enforcement action."

- **The *Brady* Rule.** The memorandum states that agencies should conform their evidence disclosure practices in civil adjudications with those practices required under the so-called *Brady* rule. Named after the 1963 U.S. Supreme Court case *Brady v. Maryland*, the rule requires prosecutors to disclose materially exculpatory evidence in the government's possession to the defense. That is, agency officials should "timely disclose exculpatory evidence to the target party of an enforcement action," using similar procedures to those set forth in the DOJ's Justice Manual.

  The adoption of the *Brady* rule could be particularly relevant in the context of SEC administrative proceedings. SEC regulations currently require the agency to make certain documents available to respondents in an administrative action, such as transcripts and documents obtained from third parties. The OMB guidance would enhance the SEC's disclosure requirements to include an affirmative obligation to disclose exculpatory and impeachment material. The SEC's procedures for producing such materials would need to meet the standards currently used by the DOJ.[1]
- **Damages and Penalties.** Agencies should also automatically disclose evidence material to the mitigation of damages or penalties.

"All rules of evidence and procedure should be public, clear, and effective."

- **Fairness and Efficiency.** Agencies should adopt or amend regulations as necessary "to eliminate any unfair prejudice, reduce undue delay, avoid the needless presentation of cumulative evidence, and promote efficiency."
- **The *Daubert* Standard.** The memorandum encourages agencies to incorporate standards set forth in the Federal Rules of Evidence, including certain hearsay rules as well as the *Daubert* standard for determining the veracity of scientific evidence.
- **Transparency.** Agencies should also make their rules of evidence and procedure available to the public by posting such information on the agency websites.

Administrative Adjudication

"Administrative adjudicators should operate independently of enforcement staff on matters within their areas of adjudication."

- **Independence of Administrative Adjudications.** Agency line adjudicators, administrative appellate entities and those engaging in informal adjudications, should operate completely independently from investigators and enforcement staff. Agencies should develop procedures of reporting and disclosure structures for violations.

"Administrative enforcement should be free of improper Government coercion."

- **Pure Motives.** Investigative and enforcement decisions (*e.g.*, selection of targets, rulings on discovery) should not be based on retaliatory or punitive motives, or on the desire to compel capitulation.
- **Restriction on Additional Investigations.** Agencies should not initiate additional investigations of a party after the commencement of an enforcement action against that party, absent a showing of good cause.

"Agencies must be accountable for their administrative enforcement decisions."

- **Prior Approval by Officer of the United States.** Investigations and enforcement actions should be initiated only with the prior approval of "an agency official who is an Officer of the United States."

[1] The CFTC has acknowledged that the affirmative disclosure obligations established in *Brady* apply to its own administrative actions. However, the dearth of administrative CFTC proceedings in recent years makes it difficult to know how the CFTC actually applies *Brady* in practice. Accordingly, it is unclear whether the OMB guidance will affect its practices in this regard.

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Currently, SEC and CFTC enforcement staff can open investigations without the approval of anyone outside of their divisions of enforcement. OMB's guidance could raise the bar for opening an investigation, for each agency, by requiring the commission, the chairman of the commission or their designees to approve the initiation of an investigation. Such a change would tend to slow the flow of investigations and might even impact the focus of investigations generally.

- **Disclosure of Adjudication Data.** Agencies should "identify, collect, and periodically make publicly available certain decisional quality and efficiency metrics regarding adjudications under bureaucratic, judicial, and split enforcement models of adjudication."

> **"Administrative enforcement should be free of unfair surprise."**

- **Reasonable Time To Respond.** A party should be afforded a reasonable amount of time to respond to agency filings or charges brought by the agency. The memorandum states that parties should have "at least as much time to respond to an agency notice of charges as parties would have to respond to filings in civil complaints brought in federal court under the Federal Rules of Civil Procedure."
- **Pre-Enforcement Rulings.** The memorandum advises that all agencies should have rules and procedures in place that make available pre-enforcement rulings.[2] Relatedly, the Executive Order directs all agencies, excluding the DOJ, to provide "[c]ompliance assistance for regulated entities." Under the Executive Order, agencies (with the exception of DOJ) are directed to accelerate procedures by which a regulated person or entity may receive a pre-enforcement ruling with respect to whether proposed conduct in response to the COVID-19 outbreak, including any response to legislative or executive economic stimulus actions, is consistent with statutes and regulations.

[2] Also required by Executive Order 13892, "Executive Order on Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication," which President Trump signed on October 9, 2019, a pre-enforcement ruling is a formal written communication from an agency in response to an inquiry from a person concerning compliance with legal requirements that interprets the law or applies the law to a specific set of facts supplied by the person.

While the impact of the memorandum on agency enforcement and adjudications remains to be seen, it has the potential to change aspects of enforcement proceedings, at least where agencies decide that current practice deviates from the Executive Order's principles and the memorandum's recommendations. Agencies may decide to decline enforcement, limit penalties where the target party "attempted in good faith to comply with the law" or narrow the scope of an investigation. Enforcement may also become more expeditious, as agencies revise practices to meet the memorandum's standards of "efficiency" and transparency.

The practical effect of the memorandum, however, will depend on the rigor with which the agencies and OMB implement its directives. The Executive Order does not provide for judicial enforcement of its provisions by private parties. On the contrary: Consistent with other executive orders, the Executive Order "is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, or entities, its officers, employees, or agents, or any other person." The memorandum serves primarily as a "guidance" document and does not establish a clear mechanism for ensuring compliance with its recommendations. For example, OIRA has decades of experience reviewing significant agency rulemakings (in both proposed and final form) for compliance with executive orders and OMB guidance. No similar procedure exists for agencies' enforcement actions; were such a procedure established, it would almost certainly raise concerns about interference by the Executive Office of the President (of which OMB is a part) in law enforcement decisions. In any event, OIRA likely lacks the resources to provide meaningful guidance to agencies on particular enforcement decisions.

Moreover, some agencies may take the position that their discretion to change procedures in conformity with the memorandum is constrained by substantive and procedural statutory provisions. Other agencies may take the view that the principles of the Executive Order are, at least to a substantial degree, already reflected in their procedures and practices. Additionally, the Executive Order's scope may be limited in instances where agencies — such as OFAC — perform actions regarding foreign or military affairs. Specifically, the Executive Order states that it does not apply to any action that pertains to foreign or military affairs, or to a national security or homeland security function of the United States, other than procurement actions and actions involving the

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import or export of nondefense articles or services. Moreover, the Executive Order purports to extend its directives to independent regulatory agencies, including the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Consumer Financial Protection Bureau and the SEC. Such independent regulatory agencies, however, have enjoyed a degree of insulation from executive oversight. While these institutions may adopt policies consistent with the Executive Order, particularly given that the independent regulatory agencies are led by appointees of President Trump, it is not clear that the president has the authority to require them to do so.

Further, agencies may not be able to implement changes right away, given the logistical challenges associated with the COVID-19 crisis. This consideration may prove to significantly diminish any long-lasting impact of the directives in the Executive Order and its related guidance, particularly in light of the approaching presidential election. Depending on the outcome of the election, it is possible that a new administration may adopt a different regulatory and enforcement agenda, resulting in suspension or withdrawal of regulatory actions taken pursuant to the Executive Order. Notwithstanding these limitations, the memorandum reflects a strong policy in favor of greater leniency and enforcement discretion as well as enhanced procedural protections for targets of enforcement.

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