OFFICE OF ATTORNEY GENERAL
STATE OF OKLAHOMA

July 11, 2022

Merrick B. Garland
Attorney General
c/o Robert Hinchman, Senior Counsel, Office of Legal Policy
U.S. Department of Justice
Room 4252, RFK Building
950 Pennsylvania Avenue NW
Washington, DC 20530

RE: Guidelines and Limitations for Settlement Agreements Involving Payments to Non-Governmental Third Parties
Docket ID DOJ-OAG-2022-0001

Dear General Garland:

The states of Oklahoma, Arizona, Arkansas, Georgia, Indiana, Kentucky, Louisiana, Missouri, Montana, South Carolina, Texas, and Utah submit these comments in response to your invitation in the above-captioned docket. We are concerned that your rule change and your related memorandum will result in the Department of Justice (DOJ) improperly funneling public funds to third-party political allies without congressional authorization, in violation of the separation of powers inherent in the Constitution and in violation of the Miscellaneous Receipts Act.

As you may recall, the DOJ rule forbidding third-party payouts in settlement agreements arose from abuses that occurred by the DOJ during the Obama Administration. In particular, the DOJ staff involved in addressing the housing crisis leveraged litigation against banks to compel those banks to donate funds to political allies of the Obama Administration. The practice of third-party payouts had been controversial prior to that experience, and it has never been clear that DOJ was acting lawfully when entering such agreements. The abuses of the 2010s magnified the potential harm from permitting the practice, and any adjustments to the rule should acknowledge that history.

Accordingly, we oppose your changes to the DOJ's settlement process and request reinstatement of the rule forbidding third-party payouts.

Comment 1: The separation of powers in the U.S. Constitution required the restrictiveness of the original rule.

Your assertion that the rule forbidding third-party payouts was more restrictive than necessary is incorrect because the DOJ is not authorized to direct public money absent appropriations. The U.S. Constitution's Appropriations Clause, for example, specifies that "No Money shall be drawn from the

Treasury, but in Consequence of Appropriations made by Law." U.S. Const. art. 1, § 9, cl. 7. To be sure, money received from outside the federal government is not technically drawn from the Treasury, but money in the Treasury and money *owed to* the Treasury are equally public funds within the control of Congress. *See* 31 U.S.C. § 3701(b)(1); *id.* § 3711. It is Congress, not the Executive Branch, that has the prerogative to allocate these funds.

One of the core distinctions between executive and legislative power is the ability to decide how to spend public funds. The first powers granted to Congress are the power to tax and the power to spend. U.S. Const. art. 1, § 8, cl. 1. The House of Representatives then has the particular power to originate "All Bills for raising Revenue." *Id.* art. 1, § 7, cl. 1. These authorities are given to Congress and to the House in particular because one of the few constraints on executive discretion is the inability to fund that discretion. The founders of our nation learned from British history, where Parliament was able to trim back the excesses of the King using its power over the purse. The Federalist No. 58 at 357 (Rossiter ed. 1961). Similarly, the separation of powers in the U.S. Constitution was designed in part to prevent the joinder of executive power and control over spending.

Including any third-party payout in a settlement agreement inappropriately conflates the executive and legislative powers. The DOJ may reasonably exercise executive discretion in choosing whether and when to settle a lawsuit. *See, e.g.*, 28 U.S.C. §§ 2414, 2677. When it chooses to funnel the funds derived from that discretion to a third party, though, it intrudes on the legislative prerogative to decide how best to spend public funds. Structuring the settlement agreement to prevent the DOJ's direct control over funds does not alter that conclusion because the intrusion on the legislative prerogative occurs when the executive branch participates in redirecting public fines or other public funds, regardless of the level of hands-on participation. In other words, the DOJ cannot escape the reality of what it is doing—usurping the legislative role—by creative settlement crafting. The separation of powers is not an obstacle to be thwarted by such transparent technicalities.

Thus, we request that DOJ reinstate the original rule prohibiting any third-party payouts because any settlement agreement that includes such payments would improperly exercise legislative authority.

Comment 2: The rule change and memorandum err by asserting that third-party payouts do not violate the Miscellaneous Receipts Act.

Your memorandum references the DOJ's view that the Miscellaneous Receipts Act (MRA) does not limit third-party payouts when settlement agreements are structured in certain ways. Neither the memorandum nor the cited Office of Legal Counsel opinion correctly explains the limits of the MRA. In particular, both the memorandum and the opinion appear to rely on the constructive receipt doctrine's criteria for tax law cases, but neither explains why that version of the doctrine, and not a different version, applies in the very different context of federal government settlement agreements.

As you know, the MRA requires that "an official or agent of the Government receiving money for the Government from any source shall deposit the money in the Treasury as soon as practicable without deduction for any charge or claim." 31 U.S.C. § 3302(b). Elsewhere, the DOJ has correctly explained that "the fact that no cash actually touches the palm of a federal official is irrelevant" for purposes of the MRA because an official may be imputed with constructive receipt of funds when the form of a transaction is disregarded in order to get to the substance. 4B Op. O.L.C. 684, 688 (1980).

The doctrine of constructive receipt addresses when money is received even when title has not passed to a particular person or agency. That doctrine may have originated in tax cases, but it is not applied with the same definition in every context. Constructive receipt exists in multiple forms depending on the factual context because, like all other equitable doctrines, it does not allow technicality to defeat application of the doctrine. "Equity eschews mechanical rules; it depends on flexibility." *Holmberg v. Armbrecht*, 327 U.S. 392, 396 (1946); *see, e.g.*, *Clark v. AII Acquisition, LLC*, 886 F.3d 261, 266 (2d Cir. 2018). As a result, equitable doctrines do not adhere to rigid criteria but instead determine what criteria "tip the balance of equities" in favor of applying an equitable doctrine in particular fact patterns. *See New Hampshire v. Maine*, 532 U.S. 742, 751 (2001). The "exercise of a court's equity powers . . . must be made on a case-by-case basis." *Holland v. Fla.*, 560 U.S. 631, 650 (2010) (quoting *Baggett v. Bullitt*, 377 U.S. 360, 375 (1964)). Equitable doctrines are applied "with awareness of the fact that specific circumstances, often hard to predict in advance, could warrant special treatment in an appropriate case." *Id.*

In tax law, the constructive receipt doctrine applies criteria that prevent tax evasion by assessing whether a taxpayer controls certain funds in substance even if not in form. *See, e.g.*, *Fakiris v. Comm'r of Internal Revenue*, 120 T.C.M. (CCH) 344 (Tax Ct. 2020). In particular, it imputes a taxpayer with income from assets credited to him, set apart for him, or otherwise made available to him, even if not actually received by him. *See* 26 C.F.R. § 1.451-2. The key inquiry is whether the taxpayer controls the funds without substantial limitations or restrictions. *See id.* "[T]ax consequences flow from the substance of a transaction rather than its form." *Id.* While constructive receipt applies particular criteria for tax cases, its ultimate goal as an equitable doctrine is to prevent individuals from using technicalities to avoid statutory tax requirements. The criteria serve the equitable goal.

Constructive receipt doctrine uses different criteria for different fact patterns, always defeating any technical avoidance of a statute. For example, in the benefits context, the Social Security Administration charges people with constructive receipt of augmented veterans' benefit funds when they have neither title to nor control over the funds. *See White v. Shalala*, 7 F.3d 296, 301 (2d Cir. 1993). Instead of using the tax law criteria for constructive receipt, the agency credits people with constructive receipt of funds given *for their benefit*. In this fact pattern, the doctrine does not allow rigid criteria of title or control to ignore the practical reality of a dependent's benefits from funds held by a fiduciary.

Similarly, money that is garnished for debts is often treated as money that is constructively received. *See, e.g.*, *Szlosek v. Sec'y of Health & Hum. Servs.*, 861 F.2d 13, 13–14 (1st Cir. 1988). The person who loses money to garnishment has no title or control over those funds. The very purpose of garnishment is to seize funds for use in a manner that the intended recipient would not apply the funds if they had title or control, redirecting the funds before receipt occurs. In this context, the doctrine acknowledges that they were about to receive the funds even if they did not satisfy the tax law version of constructive receipt, again focusing on the practical reality rather than strict criteria or technicalities.

The DOJ errs when it contends that an equitable doctrine would apply with fixed tax criteria in context of the MRA. To be sure, the relationship between the federal government and a third-party payee is not precisely like any of these fact patterns. The federal government is not a dependent of the third-party payee (SSI constructive receipt) or a debtor that owes money to the third-party payee (garnishment constructive receipt), but the federal government and the third-party payee are also not sorting out who owes income taxes. Nevertheless, the DOJ has chosen the third of those relationships—ignoring the others—as the template fact pattern without any substantial reasoning to support that choice.

It appears, in short, that the DOJ has cherry-picked a version of constructive receipt in an attempt to thwart equity and facilitate settlements that funnel money to third parties. Setting a payment needed for violation of federal law and determining how that fine is spent are central aspects of receiving money for the federal government and then spending it in violation of the MRA. Under the memorandum, the DOJ even has a role in selecting the amount of funds involved and a role in selecting the recipient or set of possible recipients, all while technically avoiding total control. Because constructive receipt doctrine is supposed to foreclose avoidance of money to which a person is otherwise entitled, *see Martin v. Comm'r*, 96 T.C. 814, 823 (Tax Ct. 1991), it should foreclose the type of settlements DOJ intends to authorize when the doctrine is applied in an equitable manner.

Accordingly, we request that DOJ withdraw its memorandum authorizing third-party settlements and reinstate a prohibition on such settlements because they violate the MRA. Should DOJ disagree with this analysis, it should explain *why*, in evaluating constructive receipt, strict tax law criteria would apply to settlement fact patterns rather than an equitable analysis designed to ferret out technicalities disguising statutory violations. DOJ has defended constructive receipt as a flexible doctrine in all of the fact patterns discussed above, and it cannot rationally deny the flexibility of the doctrine when addressing public funds in settlement agreements.

Comment 3: The change from a rule to a memorandum is arbitrary and capricious.

Your Federal Register notice provides no reasoned basis for repealing the rule entirely in favor of a memorandum. You cite two bases for changing the recent rule: (1) that you believe the recent rule was "more restrictive and less tailored than necessary," 87 Fed. Reg. 27937, and (2) that settlement policies "have traditionally been addressed through memoranda," *id.* As explained in part above, the first basis does not support repealing a rule in its entirety and cannot justify the actions here. The second basis is not sufficient to justify repeal, even if it is relevant.

An agency tradition is only a sufficient basis for repealing a rule if that tradition has an underlying basis in law. *See Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983); 5 U.S.C. § 706. A policy change based solely on the way an action was done in the past, with no legal support, is an arbitrary and capricious policy change. "[A]n agency changing its course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 42. While the DOJ may have been able to cite a continuing practice as a reason *not* to change course and adopt a rule a few years ago, *see id.*, the DOJ's decision to implement a rule means that its decision to rescind the rule is a change that requires further reasoning. The DOJ needs to explain *why* settlement policies should be in memoranda instead of just referencing a rejected tradition. It has failed to offer any such reasoning here.

A reasoned explanation is especially important here because memoranda are a bad system of management. As a former Acting Associate Attorney General has explained, the DOJ traditionally had "no central repository" where high-ranking agency officials could locate memos that are governing the agency, much less a memo organization system that the public could use. *See* Remarks of Jesse Panuccio, *Switchbacks at the DOJ the Sessions, Brand, and Garland Memos*, Mar. 3, 2022.[1] Thus, the DOJ rejected the traditional memoranda approach in favor of putting department policy in the Justice Manual or in department regulations. *See id.* This more rule-based approach promotes transparency with the public, ensures deliberation in changes of policy, and facilitates an organized management

[1] https://fedsoc.org/events/switchbacks-at-the-doj-the-sessions-brand-and-garland-memos

system within the agency. By reversing that trend, the DOJ risks decreasing transparency in its approach to an intensely controversial issue.

In short, it appears that your only basis for repealing the rule in favor of a memorandum is a tradition that the DOJ previously rejected based on sound reasoning. Such an approach, without more, is an arbitrary and capricious basis for the change. Instead of repealing the rule in favor of a memorandum, DOJ should have made any necessary changes to the rule and preserved the more transparent approach that DOJ previously implemented.

Comment 4: If the DOJ proceeds with permitting third-party payouts in settlements, the DOJ ought to require future memos on this topic to be made publicly available.

As explained above, one possible problem with the switch from a rule to a memorandum is that there is no guarantee that any future memoranda on this topic will be publicly available. Because third-party payout settlements have been highly controversial and problematic, we would request that you require all future memoranda on this topic be made publicly available.

Comment 5: If the DOJ proceeds with permitting third-party payouts in settlements, DOJ should not specify criteria for acceptable organizations for settlements.

At a bare minimum, the DOJ should modify the memorandum to avoid any involvement in selecting recipients of funds. The memorandum currently allows DOJ to "disapprove of any third-party implementer or beneficiary that the defendant proposed for consideration," subject to a requirement for "objective criteria for assessing qualifications and fitness." Memorandum at 3. As you may recall, one of the major concerns with the use of these settlements during the Obama Administration was that the "objective" criteria were in fact designed to steer settlement funds to political allies. One DOJ attorney even made this goal explicit, seeking to adjust the criteria to ensure conservative groups were not an option for funds. *See* E-mail from [redacted] (A2J) to Maame Ewusi Mensah Frimpong, July 9, 2014, 9:34 AM (bates-stamped HJC-HFC-000463).

We believe that reinstating the same criteria-based approach that the DOJ has abused previously will only lead to abuse again. The requirement for approval from the Deputy Attorney General or Associate Attorney General is an inadequate check against this abuse because lower-level DOJ staff can modify criteria to sound facially neutral while being politically biased, as occurred in the example noted above. Thus, if you choose to disregard the legal problems with third-party payouts, you should at a minimum avoid reprising past corruption and should remove the DOJ entirely from the process of selecting recipients.

* * *

We appreciate the opportunity to comment on your proposed rule change and memorandum, and we hope that you will reconsider the improper authorization of third-party payouts by the DOJ.

Sincerely,

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