DOJ Lays Out a Path to Reduced Corporate Penalties

Justice Department policy gives defense counsel a framework for winning reduced monetary penalties for fiscally poor client companies.

John J. Carney and Kayley B. Sullivan, BakerHostetler

Every year in C-suites around the world, CEOs, CFOs, and chief legal officers find themselves facing the prospect of a criminal prosecution of their company for alleged misconduct. The potential results are not only negative publicity and mandated remedial measures, but also a massive monetary penalty that could threaten the company’s very existence.

After bearing the cost of litigating or settling related civil suits and paying damages and restitution, many companies are already on a weak financial footing when they are hit with a large fine by the Department of Justice. The accumulation of these negative economic events too often forces companies to cut costs by closing facilities, selling key assets, or even filing for bankruptcy.

Struggling to find a path forward that is fair to victims, creditors, and innocent investors, the DOJ recently issued important guidance (the Memorandum) for managers and their counsel.

On Oct. 8, the department announced a new policy giving defense counsel a clear framework for building a successful argument that a criminally charged company is truly unable to pay the proposed monetary penalty and a reduction is in the interests of justice.

Historical Practices

In the past, companies seeking to lessen or avoid a criminal penalty have asserted that they are financially unable to pay the criminal fine or monetary penalty sought by the DOJ, but the factors prosecutors and judges used in evaluating these claims have not been clear.

For example, in the Foreign Corrupt Practices Act case against Odebrecht S.A. in 2016, the department granted the company a reduced fine, from $4 billion to $2.6 billion, without releasing details of what factors prosecutors considered in coming to that decision.

The courts generally have been better at detailing the factors they consider. These include an assets and liabilities analysis, the health of the economy at the time asset divestitures occur, a sole shareholder’s personal financial stability, projected revenue, and number of employees.

However, courts have been inconsistent in their application of these factors. This lack of transparency and inconsistency in the decision-making process has left company officials and defense counsel largely in the dark.

The DOJ Memorandum seeks to remedy that situation by providing much-needed transparency, consistency, and predictability to companies facing criminal fines.

Under this new guidance, once there is an agreement between the defendant and the DOJ as to the appropriate monetary penalty based on the law and the facts of the case, companies making an inability-to-pay argument will be required to complete an Inability-to-Pay Questionnaire.

The questionnaire will help the prosecutor “determine the company’s current assets and liabilities, as well as compare current and anticipated cash flows against working capital needs,” the Memorandum states.

The Factors

The questionnaire requires a company seeking a reduction to provide documents relating to:

- Recent cash flow projections
- Operating budgets and projections of future profitability
- Capital budgets and projections of annual capital expenditures
- Proposed changes in financing or capital structure
- Acquisition or divestiture plans
- Restructuring plans
- Claims to insurers
- Related or affiliated party transactions
- Encumbered assets
- Liens on the company’s assets
- Additional materials, including a complete set of audited financial statements for the past five years and year-to-date financial statements for the current fiscal year

Prosecutors may also consider a number of other factors, detailed in the Memorandum, including the
events that gave rise to the company’s current financial condition: the organization’s ability to raise capital; any significant adverse collateral consequences that are likely to result; and whether the proposed fine or monetary penalty will impair the organization’s ability to make restitution to any victims.

The Memorandum additionally outlines factors that prosecutors will generally not find to be relevant in determining whether a fine reduction is appropriate. These include “adverse impacts on growth, future opportunities, planned or future product lines, future dividends, unvested or future executive compensation or bonuses, and planned or future hiring or retention.”

Bringing an inability-to-pay claim on behalf of a company is almost certain to be a complex and fact-intensive matter. Based on previous cases, it is likely the DOJ will find the first few factors — recent cash flow projections, operating budgets and projections of future profitability, and capital budgets and projections of annual capital expenditures — among the most compelling.

The DOJ will also look for alternative sources of capital for the company, such as the ability to sell assets or equity. Prosecutors will focus on materials that most directly relate to the current and future financial state of the company.

For example, in 2014, in evaluating Alcoa Corp.’s inability-to-pay claim, the DOJ considered the company’s “ability to fund its sustaining and improving capital expenditures,” aiming to determine whether Alcoa would be able to continue to fund the things necessary to the continuation of their business.

The DOJ was also concerned that too large a fine would impair the company’s ability to effectively compete in the market. The core question the department seeks to answer through these disclosures is whether the fine is so substantial as to threaten the continued viability of the company.

Making the Proactive Case

Federal prosecutors, while highly educated and skilled in courtroom advocacy, generally do not possess a formal background in accounting and finance. Therefore, their native understanding of complex corporate accounting principles, multiyear cash flow projections and debt service requirements likely will be limited.

The Memorandum recognizes this issue and encourages prosecutors to engage accounting professionals to assist in the analysis of fine reduction requests. Consequently, counsel must work proactively with specialized forensic accountants to demonstrate in clear and concrete terms the disastrous impact that the proposed fine would have on the company.

Companies should additionally be aware that submission of these responses may subject them to increased government scrutiny. The DOJ has shown a willingness to criticize the presentation of these inability-to-pay claims when they believe companies are not using reliable accounting methods.

For example, in a recent antitrust settlement, prosecutors condemned defendant StarKist Co.’s “faulty conclusions” and methods in demonstrating their inability to pay. Especially given the clearer guidance in the Memorandum, prosecutors will not hesitate to give no credence to inability-to-pay arguments that are not well supported by the work of knowledgeable attorneys and accountants.

Companies will also benefit from being able to display and establish to the department the value to the government and public of remaining in business.

Prosecutors in past cases have homed in on potential collateral consequences and harm to the public, especially to the employees of the company and victims of the behavior at issue.

Repeatedly, in cases where the DOJ has discussed the factors they considered relevant in coming to their decision, among those listed are the ability to fund pension obligations, the need of a company to maintain employees, the potential for product shortages, and the ability to pay restitution to victims.

The DOJ may also probe what caused the company’s current financial situation. If a company is simply underperforming or may be headed toward a shutdown regardless of the imposed fine, the DOJ may be less inclined to grant a reduction.

Making the Proactive Case

When successfully argued and presented, inability-to-pay claims can lead to drastic reductions in fines for companies that badly need relief, often to the benefit of victims, employees, and shareholders.

Counsel must be armed and ready with clear and convincing factual data to push back against a prosecutor’s natural inclination that a large fine is required to achieve justice. The new guidance gives defendants at risk of serious harm an important tool in mitigating the potentially devastating injury to the company.

John J. Carney is a partner with BakerHostetler in the firm’s New York office and serves as co-leader of the firm’s national white collar defense and corporate investigations group. Kayley B. Sullivan is an associate at BakerHostetler.