

Client Alert

New Guidance from the DOJ Regarding the Inability to Pay Corporate Fines

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Contact

James G. Cavoli, Partner
+1 212.530.5172
jcavoli@milbank.com

Antonia M. Apps, Partner
+1 212.530.5357
aapps@milbank.com

George S. Canellos, Partner
+1 212.530.5792
gcanellos@milbank.com

Adam Fee, Partner
+1 212.530.5101
afee@milbank.com

Katherine R. Goldstein, Partner
+1 212.530.5138
kgoldstein@milbank.com

Tawfiq S. Rangwala, Partner
+1 212.530.5587
trangwala@milbank.com

In a memo by Assistant Attorney General Brian Benczkowski (the “Memo”) dated October 8, 2019, the US Department of Justice issued guidance on how it will evaluate a corporate defendant’s claim that it cannot afford to pay a criminal fine (or other monetary penalty) that is otherwise “appropriate.” Certain aspects of the Memo tread old ground, referencing familiar legal concepts traditionally considered when addressing such claims. For example, the Memo authorizes DOJ prosecutors to recommend, under certain circumstances, a reduction in otherwise appropriate fine levels to the extent necessary to avoid corporate extinction, and/or to avoid impairing an organization’s ability to pay restitution to victims, principles already codified in federal statute and the US Sentencing Guidelines.

Other aspects of the Memo reflect a new, broader policy—or at least formalize certain considerations that may have animated prior thinking. Most importantly, the Memo states that a reduction in monetary penalty may be warranted where the appropriate fine would likely result in “significant” or “severe” adverse collateral consequences, even where such consequences might not go so far as to jeopardize restitution to victims or the viability of the organization. While such arguments have been advanced and entertained on an *ad hoc* basis in prior cases, the Memo marks the first time that the DOJ has formally recognized that collateral consequences should be considered not only in determining the appropriate form of outcome, but also the level of monetary penalty. The Memo also provides formal notice that an inability-to-pay argument must be accompanied by detailed financial disclosures, and sets out, for the first time, a list of information and supporting documentation that must be provided to DOJ prosecutors considering such arguments.

Overall, the Memo increases transparency by clearly setting forth the criteria and analytical framework that DOJ prosecutors will apply in the face of inability-to-pay arguments and, as such, should increase consistency in approach across the Criminal Division and better equip corporate defendants in evaluating and advancing such arguments. While the practical impact of the Memo remains to be seen, it is important for organizations facing criminal dispositions and potentially debilitating monetary penalties to fully consider the newly-memorialized guidance, and to work with counsel to develop the strongest available arguments consistent with the attendant facts, including the documentation that must be provided to the DOJ.

The Guidance

The Starting Point

As a threshold matter, DOJ prosecutors will not consider an inability-to-pay argument unless and until the parties come to terms as to both the form of criminal disposition (e.g., guilty plea, deferred prosecution agreement, etc.), as well as the fine level “that is appropriate based on the law and facts, irrespective of inability to pay considerations.” Memo at 1. The former will involve analyses of, and debate over, the traditional factors considered in the context of corporate prosecutions, including the nature and seriousness of the offense, the pervasiveness of wrongdoing within the organization, a company’s prior history of malfeasance, the level of corporate cooperation, the adequacy of the company’s pre-existing compliance program, remedial efforts, and any adverse collateral consequences likely to stem from a corporate criminal charge or conviction. See Justice Manual, §§ 9-28.010-9-28.1500. The latter will often involve discussions surrounding the application of the US Sentencing Guidelines, debate as to the proper measurement of “harm”, and argument over forfeiture amounts. Assuming the parties reach “agreement” in these two areas, the DOJ will then entertain an inability-to-pay argument.

The Burden is on the Organization, Which Must “Fully Cooperate” and Provide Detailed Financial Information

The organization bears the burden of establishing its inability to pay the otherwise agreed upon fine. Moreover, it must “cooperate fully” by providing a standard list of detailed financial information, and by responding to any inquiries that may arise. Memo at 2. Specifically, a corporate defendant must provide “complete and timely” responses to the so-called “Inability-to-Pay Questionnaire,” *id.*, which calls for the following information and materials, among other things:

- All corporate cash flow projections and supporting documentation generated during the prior 12 months;
- All operating and capital budgets, as well as any projections of future profitability (including debt repayment data) and capital expenditures, created in the past year, for the present year and future periods;
- Details and supporting materials related to any plans for: (1) changes in corporate financing or the organization’s capital structure, including any debt restructuring; (2) buying or selling material assets or subsidiaries; and (3) restructuring, including any bankruptcy or liquidation plans;
- Materials relevant to any insurance claims for reimbursement of costs or expenses in connection with the DOJ matter being resolved or any other cases;
- Details and relevant documentation regarding any: (1) related-party transactions undertaken in the prior two years (or planned in the next two years); (2) encumbered assets of the organization; and (3) liens on corporate assets; and
- Other key financial documents, including audited financial statements for the prior five years and year-to-date financials for the current year (balance sheets, income statements, etc.); executed corporate income tax returns for the prior five years; recent reports regarding the aging of receivables and payables; recent appraisals and valuations; all current credit and loan agreements; and details regarding compensation for the ten most highly-paid employees within the organization.

See Memo at Attachment A. In addition to analyzing the above information, prosecutors are also likely to consult financial experts to assess the financial condition of the organization. *Id.* at 1.

Pre-Existing Considerations

As the DOJ acknowledges, certain entrenched legal principles already exist to guide courts in evaluating whether to impose a criminal fine, and the appropriate amount thereof. The Memo confirms that DOJ prosecutors should “carefully consider” those same factors when assessing an organization’s claim that it is unable to pay. *Id.* at 1.

For example, 18 U.S.C. § 3572(a) requires a district court to consider factors such as: (1) a defendant’s income, earning capacity, and financial resources; (2) the burden that the fine will impose upon the defendant and financial dependents; (3) the amount of any restitution obligation that is imposed and the need to divest the defendant of ill-gotten gains; and (4) the size of an organizational defendant, and any remedial measures taken by the organization, including whether it disciplined culpable employees. Relatedly, Section 3572(b) prioritizes the rights of victims in that it requires a sentencing court to impose a criminal fine “only to the extent that such fine or penalty will not impair the ability of the defendant to make restitution” to victims. Moreover, the US Sentencing Guidelines advise that district court judges may reduce a criminal fine below the minimum otherwise calculated under the Guidelines in the event that “the organization is not able and, even with the use of a reasonable installment schedule, is not likely to become able to pay the minimum fine required . . .” U.S.S.G. § 8C3.3(b). Under the Guidelines, an organization is “not able” to pay the minimum fine if doing so would “substantially jeopardize the continued existence of the organization.” *Id.* at App. Note. 1.

Newly Memorialized Factors

The Memo suggests that, in most instances, the DOJ will be able to determine an organization’s ability to pay based upon the responses to the Inability-to-Pay-Questionnaire, from which it will assess current assets and liabilities, and compare current and anticipated cash flows against working capital needs. Where questions remain, DOJ prosecutors will consider factors that are not specifically referenced in Section 3572 or the US Sentencing Guidelines. For example, the equities may counsel against the requested relief if the owners or management were (at least in part) responsible for the present financial circumstances because they extracted capital in the form of dividends in the recent past. See Memo at 3. In addition, the DOJ will consider the organization’s ability to borrow money or collect insurance proceeds to assist in paying the fine. *Id.*

The Memo further specifies that adverse collateral consequences should also be taken into account when addressing an inability-to-pay claim. See Memo at 1, 3. The current Justice Manual lists adverse collateral consequences as one of several factors that should be considered in determining the appropriate *form* of outcome in a corporate criminal matter. Specifically, the Manual provides that “[p]rosecutors may consider the collateral consequences of a corporate criminal conviction or indictment in determining whether to charge the corporation with a criminal offense . . .”, noting that “where the collateral consequences of a corporate conviction for innocent third parties would be significant, it may be appropriate to consider a non-prosecution or deferred prosecution agreement with conditions designed . . . to promote compliance with applicable law and to prevent recidivism.” Justice Manual § 9-28.1100A.¹

Collateral consequences now have a potentially broader impact. Under the new guidance, prosecutors must not only consider how such consequences should impact the form of outcome, but also whether they should influence the amount of a fine, even where the fine might not cause the company to go out of business. Specifically, DOJ prosecutors may recommend an adjustment to a proposed fine “based on the existence of a significant adverse collateral consequence that, while severe, may not necessarily threaten the continued viability of the organization.” Memo at n.4. While the terms “significant” and “severe” are vague, and not specifically defined in the Memo, statements elsewhere in the document

¹ Potential adverse collateral consequences from a corporate criminal charge or conviction include, but are not limited to, the “possibly substantial consequences to a corporation’s employees, investors, pensioners, and customers, many of whom may, depending on the size and nature of the corporation and their role in its operations, have played no role in the criminal conduct, have been unaware of it, or have been unable to prevent.” *Id.* Also, a criminal charge or conviction could result in a company’s debarment from eligibility for government contracts or federally funded programs . . .” *Id.*

suggest that fines that would likely result in layoffs, discontinuance of a product line, an inability to fund pension plans, or the inability to meet capital requirements may qualify. See *id.* at 3.² Prior to the Memo, the DOJ had no formal policy that prosecutors should consider collateral consequences in deciding upon the amount of a fine or other money penalty—though, as noted, such arguments have been advanced and entertained in the past. Going forward, inability-to-pay arguments can be grounded in a more clear, concrete policy that specifically recognizes that the impact of a significant fine on innocent stakeholders may be a sound basis for reduction.

DOJ Section-Chief approval is required before finalizing any fine adjustment based on a company's inability to pay. The Assistant Attorney General for the Criminal Division must also approve if the reduction is more than 25% below the otherwise appropriate fine. See Memo at 4. While the Memo provides a basis for enhanced advocacy by putative corporate defendants facing financial challenges, its impact remains to be seen, particularly given the Memo's clear caution that any adjustment should be narrowly tailored—*i.e.*, it should be enough to avoid the severe collateral consequence, but nothing more. See *id.* at n.4.

New York

55 Hudson Yards, New York, NY 10001-2163

James G. Cavoli	jcavoli@milbank.com	+1 212.530.5172
Antonia M. Apps	aapps@milbank.com	+1 212.530.5357
George S. Canellos	gcanellos@milbank.com	+1 212.530.5792
Adam Fee	afee@milbank.com	+1 212.530.5101
Katherine R. Goldstein	kgoldstein@milbank.com	+1 212.530.5138
Tawfiq S. Rangwala	trangwala@milbank.com	+1 212.530.5587

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² The DOJ also specified collateral consequences that are irrelevant in determining an organization's inability to pay, including adverse impact on growth, future opportunities, and unvested future executive compensation or bonuses. See Memo at 3.