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Clawbacks

Clawing Back the DOJ's Compensation Clawback Pilot Program

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During 2023, the legal and compliance community saw a multitude of revisions to DOJ corporate-related enforcement policies. One of the most significant policy updates was the DOJ Criminal Division's roll out in March 2023 of a pilot program relating to "Incentives and Compensation Clawback[s]" (Pilot Program). Although, according to a [speech](#) by Deputy Attorney General Lisa Monaco, the Pilot Program was introduced in part as an effort to "reward corporations" and "shift the burden of corporate financial penalties away from shareholders," we believe that the Pilot Program's Deferred Fine Reduction component, as currently drafted, fails to meet those aims in both principle and application.

See "[How Deputy AG's Focus on Clawbacks and National Security Impacts Enforcement and Companies' Compliance Efforts](#)" (Oct. 25, 2023).

The Pilot Program

The [Pilot Program](#) is broken out into two key components: Compliance Enhancements and Deferred Fine Reduction. The Compliance Enhancement component requires companies entering into a DOJ resolution to commit to having compliance-related criteria in their "compensation and bonus system[s]," and during the resolution term requires companies to report to the Criminal Division about the "implementation of such criteria," the DOJ stated. The Deferred Fine Reduction component is voluntary and aims to incentivize companies to recoup compensation from culpable employees by offering a potential for fine reduction. Both components went into effect in March 2023, will remain in effect for a three-year period and apply to all corporate matters before the DOJ's Criminal Division. At the end of the three-year period, "the [Criminal] Division will determine whether the [Pilot] Program will be extended in duration or modified in any respect," according to the same DOJ statement.

This article focuses on the Deferred Fine Reduction component, which provides that a company may receive a fine reduction of 100% of the amount of compensation the company recoups from employees involved in the underlying wrongful conduct. However, the compensation must be

recovered during the period of monitoring or reporting called for in the resolution, and the company must also fully cooperate, remediate and implement a company program to recoup compensation from the culpable employees. If the compensation is not retrieved during the resolution term, the company might receive a fine reduction, but such reduction would be at most equivalent to 25% of the amount of compensation sought to be recouped during the resolution term.

In order for a company to qualify for such a 25% reduction, the Criminal Division must find that “good faith” attempts were made by the company to recoup the compensation during the resolution period. The Pilot Program offers examples of instances in which a company did not recoup compensation during the resolution term but still might qualify for a fine reduction: “a company incurr[ing] significant litigation costs for shareholders” or “demonstrat[ing] that it is highly likely that it will successfully recoup the compensation shortly after the end of the resolution term.”

Lastly, it’s important to understand that any fine reduction under the Pilot Program’s Deferred Fine Reduction component is within the sole discretion of DOJ Criminal Division prosecutors.

Shifting of Governmental Functions; Impracticable in Application

There is no doubt that strengthening company compliance systems is a laudable goal, and therefore the Pilot Program’s Compliance Enhancement component is, in this respect, relatively benign. The Deferred Fine Reduction component, however, is not. As discussed below, the Deferred Fine Reduction component requires companies to assume the government’s burden of punishing individual wrongdoers and presents numerous logistical and practical difficulties that may render it impracticable in application.

Existing Federal Government Frameworks Are Already Sufficient

The federal government has broad statutory authority and the responsibility to investigate and punish those who violate federal law and to seek, among other remedies, criminal and civil financial penalties. Indeed, the DOJ literally has thousands of criminal offenses available to it in the U.S. Code, along with statutorily authorized resources to impose and collect financial penalties – see [28 C.F.R. § 0.171](#). The DOJ also has numerous existing policies and legal frameworks to effectuate these ends.

For example, as described further in the Justice Manual ([§ 9-28.700](#)), the DOJ has a well-developed and successful set of incentives for companies to cooperate and provide information to the government regarding violations of federal law. In order for a company to obtain cooperation credit, certain factors must be met, including that a company timely disclose “significant facts” and “identify all individuals involved in or responsible for the misconduct at issue[.]” This system is designed to facilitate the DOJ’s investigation and prosecution of culpable individuals, which presumably would include financial penalties. Despite requiring companies to disclose this detailed information, the

Criminal Division now seeks to outsource its responsibility to pursue culpable individuals – a law enforcement responsibility the DOJ has previously called the “strongest deterrent against future corporate wrongdoing.” (§ 9-28.000).

Not only does the federal government have statutory power to charge and collect financial penalties against individuals, the SEC has already instituted a rule addressing clawbacks in certain instances. In October 2022, the SEC finalized Rule 10D-1, codified at 17 C.F.R. § 240.10D-1, requiring listed issuers, with certain limited exceptions, to develop and implement a policy to recover executive officers’ incentive-based compensation when an accounting restatement is required and such compensation was based on the incorrectly reported financial information. Rule 10D-1 stands in stark contrast to the DOJ’s Deferred Fine Reduction in two key respects: (1) Rule 10D-1 is not a fault inquiry, rather it applies irrespective of fault when an accounting restatement is required; and (2) Rule 10D-1 provides an exception to the clawback component when such a clawback would be “impracticable,” such as when the expense to enforce the policy would exceed the amount to be recovered, or when recovery would violate the law. The Pilot Program, on the other hand, drastically expands the scope of corporate compensation recoupment, including clawbacks.

See “[SEC Clawback Rule Requires Focused, Coordinated Compliance](#)” (Aug. 2, 2023).

The Deferred Fine Reduction Component May Prove Impracticable in Application

In addition to shifting the government’s enforcement burden onto private companies, the Deferred Fine Reduction component may prove largely impracticable in application for several key reasons:

- the Pilot Program does not clearly delineate what standard should trigger compensation recoupment, or who should be responsible for deciding when such a standard has been met;
- given the Pilot Program’s discretionary elements, the potential fine reduction would not sufficiently take into account risk or expense to the company;
- multinational companies may be unable to recoup compensation given applicable local labor laws, particularly outside the U.S.; and
- in certain circumstances, compensation recoupment may conflict with the overriding need to promptly remove wrongdoers from positions of trust.

Applicable Standards

As mentioned above, the Pilot Program requires a finding of fault to trigger disciplinary compensation recoupment, but no clear standards are provided as to when misconduct should trigger disciplinary measures. The Deferred Fine Reduction component merely indicates that compensation should be recouped from two categories of individuals: (1) “employees who engaged in wrongdoing in connection with the conduct under investigation,” or (2) “others” who had “supervisory authority” over either the employee or business area, and “knew of” or were “willfully blind to, the misconduct[.]” The Pilot Program does not delineate whether the burden of proof should be clear and

convincing, beyond a reasonable doubt, or a preponderance of the evidence, nor does it indicate whether “employees who engaged in wrongdoing” need to have done so intentionally, recklessly, knowingly or merely negligently.

Furthermore, the Pilot Program does not suggest who should decide or adjudicate when the standard has been met. For example, whether these decisions should be made by the board of directors, human resources, GC or an independent decision maker remains to be seen. And whether such decisions should be made on a case-by-case basis, or be generally applicable, is also up for discussion. Such a standardless policy will inevitably lead to inconsistent application and disparate outcomes.

“Good Faith Attempt” and Lack of Cost/Benefit Considerations

Ironically, while claiming to ameliorate financial penalties to shareholders, the failure to do so is perhaps most on display when it comes to the calculation of fine reductions under the Pilot Program.

As mentioned above, the Deferred Fine Reduction component serves to credit companies up to 100% of the amount of compensation the company recouped, if the company also fully cooperates, remediates and implements a policy to recoup compensation from the culpable employees. However, terms and conditions apply. Critically, a company will not receive full credit for compensation that it recoups after the resolution term, or for compensation that it attempted in “good faith” to recoup but was unable to obtain. In such a likely scenario, a company stands to obtain at most 25% of the amount of compensation it sought to recoup or recouped late.

To illustrate this, consider the following scenario: Company A is entering into a resolution with the Criminal Division and has initiated litigation to clawback \$100,000 of compensation from Wrongdoer A, but has not yet obtained any money. Prosecutor A may, in her discretion, award a “Possible Clawback Reduction” off the fine amount up to \$100,000 at the time of entering into the resolution agreement with Company A.

If, by the end of the resolution term, Company A has still not clawed back any money from Wrongdoer A, Company A will owe \$100,000 to the Criminal Division, unless Prosecutor A determines that Company A made a “good faith attempt” to clawback the compensation from Wrongdoer A. If Prosecutor A arrives at this conclusion, Company A will still owe at least \$75,000 to the Criminal Division. Alternatively, if Company A successfully clawed back \$20,000 of the \$100,000 it sought from Wrongdoer A before the end of the resolution term, it seems Company A will still owe at least \$60,000 to the Criminal Division (25% off of the \$80,000 unsuccessfully recouped).

It is not yet clear what will make an unsuccessful attempt good (faith) enough to warrant a fine reduction. The Pilot Program indicates that such a fine reduction may only be “warranted where, for instance, a company incurred significant litigation costs or can demonstrate it is highly likely to recoup compensation shortly after the end of the resolution term.”

Critically, other than a possible reduction of up to 25% of the compensation unsuccessfully recouped or recouped late, the Pilot Program does not reduce a company’s fine based on the litigation

or other financial expense to the company, or any potential liability, reputational and other risks the company may face as a result of initiating the recoupment process. Nor is the reduction based on the total fine amount.

Indeed, even in the best-case scenario where a company has successfully recouped compensation during the resolution term, the amount to be gained could remain relatively slim in relation to the fine amount. In the recent FCPA [settlement](#) of Albemarle Corporation, the company agreed to pay the SEC and DOJ approximately \$218 million in fines and penalties and obtained a credit of only \$763,453 for withholding bonuses under the Pilot Program. This “reward” – less than .5% of the overall fines – seems unlikely to move the needle for corporate boards and management teams.

Implications for Multinational Companies

Though the Pilot Program emphasizes clawbacks, it leaves open the form of compensation recoupment. This is critical as a company’s success at obtaining a fine reduction will vary greatly depending on what form of compensation recoupment is available to it.

In many jurisdictions, clawing back compensation will be unavailable as a result of local labor laws. For example, in France and Germany such clawbacks may be illegal outside of certain industries. Deducting wages may be illegal under certain U.S. state wage laws. Therefore, a company’s ability to obtain credit under the Deferred Fine Reduction component will be dependent, in part, on the jurisdiction(s) in which it finds itself. How the Criminal Division will weigh these jurisdictional vicissitudes remains to be seen.

Compensation Recoupment or Removing Wrongdoers

As noted earlier in this article, the Pilot Program is just one of many DOJ policies geared toward incentivizing stronger corporate compliance programs. At times, these incentive systems may conflict or create crosscurrents. In certain circumstances, the Deferred Fine Reduction component could hinder expeditious removal of wrongdoers from positions of trust. The U.S. Sentencing Guidelines under [U.S.S.G. §8B2.1\(b\)\(2\)\(B\)](#) clearly state that in order for a company to have an effective compliance and ethics program “the organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known . . . has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.”

Oftentimes, when misconduct has been identified, a company’s first goal is to remove responsible individuals to prevent further misconduct or the spoliation of evidence. Usually, this removal process occurs by mutual agreement, or written release, where the company agrees to pay some severance to the employee and the employee agrees, absent certain exceptions, not to litigate their dismissal. Incorporating findings of fault and disciplinary compensation recoupment into this process raises the likelihood of employees refusing to agree to their dismissal.

In many jurisdictions outside the U.S., removal of an employee for cause must occur within a short period of the conduct, such as 30 days. This is often insufficient time to investigate and reach a factual conclusion as to an employee's culpability. Such a scenario could lead to the employee remaining in their position until notice periods are up, or litigating their dismissal and actually obtaining reinstatement, as [reported](#).

See "[Albemarle Resolutions Bring First Application of DOJ's Compensation Incentives and Clawbacks Pilot Program](#)" (Nov. 8, 2023).

Conclusion

In many cases the Criminal Division's Deferred Fine Reduction component does not sufficiently "reward corporations" or shift economic burdens away from shareholders. The federal government is best situated to assess, enforce and collect financial penalties from individual wrongdoers. The DOJ's recent attempt to place this burden on companies is ill-advised and likely to be ineffective.

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