

Weighing Ability To Pay Criminal Fines Amid FCPA Crackdown

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With an expected uptick in enforcement under the Biden administration and the recent passage of the National Defense Authorization Act for fiscal year 2021,[1] organizations may find themselves facing criminal fines or other monetary penalties that could, in essence, break the bank. Organizations could become unviable, unable to pay restitution to victims or be forced to initiate employee layoffs.

Embedded in the NDAA is the explicit granting of authority and the extension of the statute of limitations from five to 10 years for certain scienter-based violations in federal district court.[2] While the U.S. Supreme Court's 2020 decision in *Liu v. U.S. Securities and Exchange Commission* may still limit liability[3] with longer scope periods, disgorgement amounts sought by regulators will likely trend higher.

Further, SEC Commissioner Caroline Crenshaw noted in March that penalties should be higher for violations that cause more harm and are more difficult to detect in order to deter misconduct and encourage organizations to foster a culture of compliance.

This, combined with the economic fallout from the coronavirus pandemic, may make an organization's inability to pay criminal fines or other monetary penalties a more prominent aspect of resolutions of Foreign Corrupt Practices Act violations, if not a fixture in such cases where extended disgorgement is sought.

And if there are concerns about whether bribery and corruption enforcement will slow, several trends point to the contrary. In 2020, \$2.8 billion[4] in fines was recovered by the SEC and U.S. Department of Justice to resolve corporate FCPA violations, and over 200 bribery and corruption tips were submitted through the SEC's whistleblower program.

Further, regulators have already indicated a more aggressive stance to enforcement, with the SEC granting authority in February to senior attorneys at the commission to initiate investigations[5] and the DOJ growing the foreign bribery unit to a record size as of March.[6]



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Background of Inability to Pay

In October 2019, the DOJ's Criminal Division released additional guidance^[7] regarding an organization's assertion of an inability to pay a criminal fine or monetary penalty. The guidance was intended to provide consistency and transparency by outlining a framework for the division to assess claims by companies asserting an inability to pay an otherwise appropriate criminal fine.

Combined with the U.S. Sentencing Guidelines Section 8C3.3 and the Criminal Fine Improvements Act of 1987, this guidance enables parties to FCPA enforcement actions to submit claims demonstrating an inability to pay such fines.

According to the 2019 guidance, if the DOJ determines that a company is unable to pay, then the department should recommend an adjustment to the fine with the goals of:

- Avoiding a threat to the continued viability of the company; and/or
- Positioning the company to provide restitution to victims.

Such adjustment may include reductions to the fine itself and/or increasing the time period during which the company is obligated to pay penalties and restitution.

An organization's inability to pay an agreed-upon criminal fine is typically determined by an analysis of its assets and liabilities, and current and anticipated cash flows, an analysis that is analogous to an assessment of working capital requirements.

The organization itself maintains the burden of establishing the claim and must cooperate with the DOJ throughout each step of the process, and further, must provide complete and timely responses to the DOJ's inability-to-pay questionnaire.

Inability to Pay at Play

In September 2020, prosecutors applied this most recent guidance to an inability-to-pay claim by Sargeant Marine Inc., a Florida-based asphalt company that pled guilty to conspiring to violate FCPA anti-bribery provisions over an eight-year period.^[8] The allegations in this matter related to SMI bribing foreign officials in Brazil, Venezuela and Ecuador between 2010 and 2018 for the purpose of obtaining contracts to purchase or sell asphalt to state-controlled companies.

This case has many hallmarks of a prime bribery and corruption case as well as some novel schemes. Elements made public include:

- Bogus consulting agreements and fake invoices to funnel bribes to government officials and state-owned oil company executives;
- Code names to hide the identities of government officials; and
- Draft emails in a shared U.S.-based email account to allow the perpetrators to communicate remotely without transmitting emails outside of the email account.

One could surmise that these facts favor the prosecution, and an enforcement action with an accompanying appropriate criminal fine should follow suit.

SMI's alleged profits were approximately \$38 million based on such conduct in Brazil, Venezuela and Ecuador. Thus, the U.S. Sentencing Guidelines suggest a penalty range between \$120 million and \$240 million. However, based on SMI's full cooperation and remediation efforts, the department reduced the bottom range of the penalty by 25% to \$90 million.

The DOJ then analyzed SMI's financial records with the help of an independent forensic accountant to determine how much of the \$90 million fine SMI could reasonably pay.

Although many details are not publicly available, the DOJ did disclose in the plea agreement with SMI that two primary factors supported SMI's claim of an inability to pay the fine. Notably, those factors were (1) the company's current, stressed financial condition, and (2) limited alternative sources of capital.

These factors, as well as those outlined in the Criminal Fine Improvements Act and the U.S. Sentencing Guidelines Section 8C3.3(b), resulted in the DOJ reducing the fine to \$16.6 million, a discount of approximately 80%. In addition, as noted in the plea agreement, the DOJ deemed a fine of \$16.6 million sufficient but not greater than necessary to achieve the purposes described in Title 18 of the U.S. Code, Section 3553.

Although the DOJ has previously utilized inability-to-pay analyses to reduce criminal fines related to violations of the FCPA — such as in the 2014 case *U.S. v. Alcoa World Alumina LLC* in the U.S. District Court for the Western District of Pennsylvania^[9] and the 2010 case *U.S. v. Innospec Inc.* in the U.S. District Court for the District of Columbia^[10] — it was less clear how the prosecutors assessed the inability-to-pay claims.

The additional guidance issued by the DOJ in 2019, along with the information made public regarding the outcome of the SMI matter, is intended to provide a consistent framework for how inability-to-pay claims may be assessed going forward, and consequently, how organizations make strategic decisions when faced with a potential FCPA violation, such as the decision to self-disclose.

Considerations for Ability to Pay

Like SMI, companies can consider the factors outlined by the DOJ to assess the reasonableness of fines in the context of their ability to continue operations. The ability-to-pay guidelines from the DOJ include the four factors below.

1. Current Financial Condition

- Can the company fund violation-related obligations from existing cash?
- Will near-term profits be sufficient to ensure viability of the company in light of required fines and restitution?
- Will reputational risk be incurred if profitable companies claim an inability to pay?
- Are stock buybacks, dividend payments or layoffs concurrently taking place?

2. Alternative Sources of Capital

- Can the company sell assets to raise funds?
- Can credit facilities be accessed?
- Can capital markets be accessed via debt or equity offerings?
- Have reserves been set aside to account for potential financial obligations?

3. Collateral Consequences

- Will the company be forced to initiate layoffs?
- Will pension obligations or other obligations that benefit the broader economy, such as environmental remediation efforts, be imperiled?

4. Victim Restitution

- Can the organization afford to provide restitution to victims?
- Are there programs or an extended timeline that the company can initiate to more manageably incur the cost of compensating victims?

As noted in the DOJ's 2019 guidance, the department will assess an organization's ability to pay an agreed-upon criminal fine or monetary penalty based on an organization's responses to the DOJ's inability-to-pay questionnaire. As the questionnaire indicates, the DOJ recognizes that such analysis is a complex and laborious exercise, as evidenced in detailed and lengthy requests.

Requests in the questionnaire include, but are not limited to, cash flow projections, operating and capital budgets, acquisition or divestiture plans, related-party transactions, liens on assets, and five years of audited financial statements and tax returns.

Once companies assess an inability-to-pay claim for a criminal fine or monetary penalty, larger organizations may conclude that submitting such a claim is not applicable or effective. However, for smaller companies, assessing its ability to pay a fine could certainly be impactful when the fines could be detrimental to the viability of the organization.

As stated in the DOJ's recent guidance, "In most cases, prosecutors also will need to consult an accounting expert to examine the financial condition of the business."^[11]

With regulators increasing their bench and their investigative authority, and an expected uptick in bribery and corruption enforcement, momentum is picking up in the FCPA space and consequently, inability-to-pay claims are likely to rise in prominence. There remains much to consider.

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Disclosure: While CRA's experts regularly advise clients on matters involving inability-to-pay, bribery and corruption, the company was not involved in any specific case cited in this article.

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[1] § 6501(a).

[2] Ibid.

[3] <https://www.law360.com/articles/1285320/high-court-preserves-sec-disgorgement-with-limits>.

[4] <https://www.gibsondunn.com/2020-year-end-fcpa-update/> and <https://www.debevoise.com/-/media/files/insights/publications/2021/01/fcpa-update-january-2021.pdf>.

[5] <https://www.sec.gov/news/public-statement/lee-statement-empowering-enforcement-better-protect-investors>.

[6] https://www.wsj.com/articles/justice-departments-foreign-bribery-unit-adds-prosecutors-compliance-expertise-11615199402?mod=searchresults_pos4&page=1.

[7] <https://www.justice.gov/opa/speech/file/1207576/download>.

[8] <https://www.justice.gov/opa/pr/sargeant-marine-inc-pleads-guilty-and-agrees-pay-166-million-resolve-charges-related-foreign>.

[9] <https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2014/01/15/01-09-2014plea-agreement.pdf>.

[10] <https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2011/02/16/innsoprec-sentencing-memo.pdf>.

[11] <https://www.justice.gov/opa/speech/file/1207576/download>.