DOJ's Compensation Reforms Pit Cos. Against Their Execs

By **Solomon Shinerock and Annika Conrad** (April 12, 2023)

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According to recent policy announcements, the U.S. Department of Justice is increasing incentives for corporate cooperation to further its goal of prosecuting individuals rather than the corporations where they work.

While the DOJ has long pursued this goal, the recent changes create firm new incentives for corporations to report wrongdoing by their officers and employees.

The trend to shift focus from huge fines that harm innocent investors in favor of more surgical punishment of individual bad actors has a compelling moral ring. However, corporate executives and counsel alike should be aware of the unintended consequences, including potential ethical conflicts in the representation of individuals and corporations facing DOJ investigations.

Because the new policy pits corporations against their executives and employees in new ways, those individuals have an increasingly urgent need to protect themselves early on in the course of internal investigations.

Recent Updates to DOJ Early Disclosure Incentives

At a March 2 speech at the American Bar Association's annual National Institute on White Collar Crime, Deputy Attorney General Lisa Monaco expanded on recently issued changes to the DOJ's corporate enforcement policy.

Monaco described the changes as part of a three-year pilot program to incentivize corporations to self-report to prosecutors as soon as the company recognizes it has potentially been involved in fraud, money laundering or other white collar crimes.

To entice companies to cooperate, the DOJ announced that companies that disclose wrongdoing will not be prosecuted if they fully cooperate with investigators and fix the underlying problems, including any shortcomings in their compliance programs.

Additionally, companies whose top executives participated in the wrongdoing, or that profited significantly from the misdeeds, could still get a declination of prosecution if they immediately self-report and provide "extraordinary cooperation," or demonstrate that they have an effective compliance program. The department has yet to define these terms.

Structuring Compensation Programs to Promote Compliance

In addition to the avenues for leniency described above, the department will now reward corporations that institute compensation programs intended to promote compliance and claw back payments made to law-breaking executives and employees.

Corporations can reduce their fines by the amount clawed back or by some portion of the amount attempted to be clawed back in good faith.

These programs will be evaluated based on the particularized risk and business profiles of each company, but are expected to come in two primary forms:

- Punishment and deterrence — claw back arrangements whereby employees involved in misconduct can lose previously paid or accrued compensation; and
- Incentives and promotion — tying bonus compensation to demonstrated compliance.

Because each company has a unique risk and compliance profile, the department has said that there is no standard formula that compliance programs will be evaluated on.

That said, the DOJ's Evaluation of Corporate Compliance Programs released a series of factors it will consider, including: (1) the methodology the company has used to identify, analyze and address the particular risks it faces; (2) whether the policies are communicated and enforced; (3) whether the company has sufficient staff to audit, document, analyze and utilize the compliance efforts, or is, in essence, a paper program; and (4) the commitment to compliance by senior and middle management.[1]

As an example of compliance-focused compensation programs, the department has cited its recent resolution with Danske Bank, which involved a sentence of three years' probation and roughly $2 billion in global restitution arising from money laundering conducted through the bank's Estonian branch.

The department inserted a provision in the Dec. 12, 2022, plea agreement that requires Danske Bank to tie executive compensation to compliance. Specifically, Danske is required to implement policies linking executive performance evaluation and bonus qualification to specific compliance criteria. An unsatisfactory score in compliance will make the executive ineligible for any bonus that year.[2]

Given that for many top executives, bonuses are equal to or greater than base salary, this is a powerful provision.[3]

Provisions like the above empower a company to monitor its employees, uncover wrongdoing and penalize the bad actors, all internally.

Compensation structures that deter misconduct create positive incentives to generate a culture of compliance. And if an individual actor strays from compliance, the company can then claw back compensation paid to the wrongdoer to offset its own liability and potential fines.

Part of an Attempt to Increase the Number of White Collar Prosecutions

The department has long sought to incentivize corporations to take on some of the burden of investigating challenging, complex white collar fraud cases. And for good reason: These cases — increasingly recognized as meaningful and essential to a healthy financial system on which most Americans rely — are notoriously difficult to prosecute.

In the mid-1990s, white collar prosecutions represented an average of 17.6% of all federal cases. At the end of 2012, that number was down to 9.4%.[4]

The DOJ has since sought to reverse the trend. Policy support for its efforts was implemented by former President Barack Obama's Deputy Attorney General Sally Yates in 2015,[5] and former President Donald Trump's Deputy Attorney General Rod Rosenstein in 2018,[6] among others.

But white collar investigations and prosecutions are time-intensive; the review process for white collar prosecutions is 3.6 times longer than the average federal prosecution.[7] The investigation of an individual suspected of a white collar crime takes about 452 days on average, and an investigation into a corporation takes twice as long.[8]

While overall, federal prosecutors charged approximately 70% of all criminal referrals they received in 2022, for white collar offenses, the odds of prosecution dropped to 38%, and the odds of prosecution against a business organization dropped to 5%.

Against this backdrop, it is no surprise that the DOJ is renewing its efforts to spread the burden of investigation among the corporations involved in misconduct and continue its focus on individuals.

But the new, enhanced incentives announced by Monaco reflect more than the DOJ's continued push to prosecute more white collar crime: They create an approach to cooperation credit that pits corporations against their executives and employees in new ways. In doing so, they raise many questions, and invite unintended consequences.

Corporations and Their Employees Will Find Their Interests at Odds

This policy advances the inflection point when a corporate executive will need to seek independent representation.

In general, corporations and their employees have similar goals when under investigation — to avoid liability and, if liable, to minimize penalties. Under this new policy, their pursuit of those goals may often diverge much earlier than before.

The quickest way the company can reach its goal of minimizing liability and penalties is by exposing individuals involved in misconduct to prosecutors and regulators, and by taking internal remedial steps such as clawing back their salaries and bonuses and terminating their employment.

The policy invites companies to disclose suspected misconduct by employees much earlier in an internal investigation, perhaps even before the investigation is complete.

The enhanced early disclosure incentives promote a public-private cooperation incentive program where corporations can avoid indictment and minimize financial penalties through early disclosure, and the department saves the time and resources that would have been spent launching such full-scale investigations.

Where whistleblower programs have long incentivized employees to out their employers, increasingly companies will now be looking to out their employees.

These new cooperation incentives shift the focus to the liability of the individual wrongdoer. Companies are unlikely to shield executives from liability.

Given this dynamic, corporate counsel need to consider whether they can ethically represent employees much earlier in an investigation.

In the context of internal investigations, corporate counsel are already accustomed to issuing Upjohn warnings — an explanation that the lawyer represents the company, and that the company holds the attorney-client privilege and may waive that privilege at any time, but the employee must keep the details of the interview confidential.[9]

But now that the corporation has a greater incentive to root out bad actors, are more robust warnings required concerning the potential conflict of interest between the corporation and its executives?

At what point does corporate counsel become an agent of the government for constitutional and attorney ethics purposes? What conversations need to happen when the interests of the corporation and its executives are at odds prior to any impending government investigation?

And could the policies backfire, insofar as executives may retain counsel and refuse to cooperate, rather than voluntarily subject themselves to an increased likelihood of compensation clawbacks, termination, and exposure to government regulators and prosecutors?

Perhaps more concerning, what happens when corporate counsel, without the benefit of the checks and balances required for regulatory and prosecutorial decision making, come to the wrong conclusion concerning an executive's conduct?

Absent clarifying guidance from the DOJ, counsel and other stakeholders will have to grapple with these questions, and draw conclusions as they are resolved piecemeal in practice by courts and DOJ resolutions.

Executives need to be careful; they cannot rely on corporate counsel to determine when they need their own separate representation anymore. This policy sharpens the line between the corporation and the nonrepresented employees and executives.

Executives should consider negotiating contractual rights to the appointment of separate legal counsel much earlier in the process of an investigation than many compensation packages currently provide.

It will be difficult to assess the precise triggers for such appointment of separate counsel, but corporate executives would be well advised to insist on the broadest language possible implicating the right to independent counsel at the earliest points in an investigation.

Overall, these policies increase the DOJ's power to conscript corporate compliance and general counsel personnel into an investigative role supporting law enforcement, and to do so much earlier.

This is especially useful to the department where ordinary investigative methods would not otherwise suffice to catch complex wrongdoing.

However, it does complicate the relationship between corporations and their officers and managers, and shifts more of the burden to employees to protect themselves in the face of internal investigations.

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