

Considerations And Calculations For DOJ Clawback Program

By **Yogesh Bahl and Jonathan Hecht** (October 17, 2023, 3:07 PM EDT)

The focus by the U.S. Department of Justice on individual accountability for corporate wrongdoing is not a new concept.

However, the DOJ's three-year compensation incentives and clawbacks **pilot program**, announced by the Criminal Division in March, has raised several considerations on if, how and when to implement certain changes in a company's compliance program in connection with compensation and incentives.

As an example of the clawback program in action, on Sept. 29, the DOJ **announced a resolution** with Albemarle Corp.

According to a Justice Department press release, Albemarle has "agreed to pay more than \$218 million to resolve investigations by the U.S. Department of Justice and the Securities and Exchange Commission (SEC) into violations of the Foreign Corrupt Practices Act (FCPA) stemming from Albemarle's participation in corrupt schemes to pay bribes to government officials in multiple foreign countries." [1]

As part of the resolution with the DOJ, "Albemarle entered into a three-year nonprosecution agreement ... with the Department and agreed to pay a penalty of approximately \$98.2 million and administrative forfeiture of approximately \$98.5 million."

The press release notes that "the penalty reflects a reduction of \$763,453 under Part II of the Criminal Division's [clawback program] for bonuses that the company withheld from qualifying employees." [2]

This is one of the first resolutions with the DOJ demonstrating a credit against fines and penalties under the DOJ's clawback program.

In this article, we first briefly discuss certain specifics of the clawback program, and then, for context, we include some actual data of the average amount of compensation for top CEOs in the life sciences and health care industry, as an example.

We then include some employment-related, strategic and economic considerations based on our experience before including an illustrative calculation involving the potential clawbacks.

We end the article with brief closing thoughts using the Albemarle resolution as an example.

The DOJ Clawback Program

During the DOJ's three-year clawback program, every corporate resolution entered with the Criminal Division will include requirements to implement criteria, and report annually regarding the implementation of the criteria, which

may include but are not limited to: (1) a prohibition on bonuses for employees who do not satisfy compliance performance requirements; (2) disciplinary measures for employees who violate applicable law and others who both (a) had supervisory authority over the employee(s) or business area engaged in the misconduct and (b) knew of, or were willfully blind to, the misconduct; and (3) incentives for employees who demonstrate full commitment to compliance processes." [3]



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The pilot program also provides opportunity for a reduction of the fine levied by the Criminal Division, in addition to any other reduction available under applicable policy,

if a company fully cooperates and timely and appropriately remediates and demonstrates it has implemented a program to recoup compensation from employees who engaged in wrongdoing in connection with the conduct under investigation, or others who both (a) had supervisory authority over the employee(s) or business area engaged in the misconduct and (b) knew of, or were willfully blind to, the misconduct, and has in good faith initiated the process to recoup such compensation before the time of resolution, an additional fine reduction may be warranted.[4]

In the above circumstances, the reduction of the fine could equal 100% of any such compensation that is recouped during the period of the resolution.

However, any fine reduction would not "affect any other applicable restitution, forfeiture, disgorgement, or agreed-upon payment by the company." [5]

In addition, under the pilot program, if a company's good faith attempt to recoup any such compensation is unsuccessful, division prosecutors have the option — at their discretion — to provide a reduction of up to 25% of the amount of compensation the company attempted to claw back.[6]

This provision might apply, if, for example, the company incurred significant litigation costs for shareholders in trying to claw back compensation or it can demonstrate that it is highly likely that it will successfully recoup the compensation shortly after the end of the resolution term.

CEO Compensation for Additional Context

Below, we have included the average amount of compensation of top CEOs in the life sciences and health care industry to provide one example.

This is not to say CEOs are necessarily involved with corporate wrongdoing, but more so to understand the upper levels of compensation for an individual within a company that could be subject to clawback.

Using one public source[7] of CEO compensation — the AFL-CIO, which details compensation by salary, bonus, stock-based compensation, nonstock incentives, etc., — we calculated the range and mean of the top 62 S&P 500 life sciences and health care CEOs and prepared the table below.[8] All the amounts below are in millions of dollars.

S&P 500 Healthcare Executive Compensation Statistics for the Years 2021 & 2022

Compensation Category	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation
Salary	\$0.78	\$1.80	\$1.29	\$0.26	20%
Stock Awards	- [9]	\$15.84	\$7.91	\$4.05	51%
Option Awards	- [10]	\$11.25	\$3.13	\$2.59	83%
Non-Equity Compensation	\$0.64	\$8.00	\$2.82	\$1.46	52%
All Other Compensation	\$0.00 [11]	\$1.38	\$0.31	\$0.28	91%
Total Compensation	\$3.30	\$28.62	\$15.61	\$5.21	33%

As can be seen by the standard deviation and measurement of variance in the table above, there is a nontrivial variation from CEO to CEO, and the level of variation depends on the type of compensation.

This serves to emphasize the point that the decision to claw back potential compensation in exchange for penalty reduction will have a different cost-benefit calculus depending on the company and the circumstances

of the case.

Strategic, Employment-Related and Economic Considerations Involving Compensation Clawbacks

The cost-benefit calculus will also be shaped by several other considerations, including those that involve strategy, human resources, and economics. The following are some of those considerations.

Strategic Considerations

- Given that this is a pilot program, does the company proactively adopt and implement changes to the corporate compliance program now, or wait and see how the pilot program develops?
- What type of compensation would be subject to clawback — salary, bonus, stock awards, deferred compensation, nonstock awards, increase in pension values and so on?
- What is the behavioral impact of implementing incentives for actions individuals should be performing anyway?
- Should corporatewide policies, including codes of conduct, be modified to state which types of employee compensation are susceptible to clawback in the event an employee is involved in a violation that is subject of a corporate resolution with a regulator?
- If the company is to proactively implement changes to its corporate compliance program, does it need to implement the changes globally wherever allowed by local law, and make changes to its talent management systems, competency models, compensation models and employee training?
- If it does not already, does the company's risk-assessment approach need to be further connected to the company's talent-management approach for employees who do not complete compliance training or other requirements timely?
- When attempting to reach an agreement on the corporate resolution, what is the strategy in negotiating each financial component of the resolution within the context of the total financial amount to be paid by the company?

Human Resources and Employment Considerations

- From a talent acquisition perspective, would certain candidates refuse employment contract provisions containing clawback provisions, and would companies lose access to talent who select employers that do not require such provisions in their contracts?
- How do companies balance negligence, indemnification, and directors and officers insurance provisions in employment agreements?
- For the relevant employees, do employment contracts need to be modified to include provisions for the potential clawback of compensation?
 - If so, would the clawback apply to salary as well as other types of compensation, such as stock awards or deferred compensation?

- What is the most efficient way to obtain a complete understanding of the applicable employment laws in each of the jurisdictions the company operates to know where and how to implement the needed language in employment contracts?

Economic Considerations

- If the company decides to proactively change its corporate compliance program now, what are the total anticipated internal and external costs for implementation?
- How does the total amount of the potential compensation clawback compare to the amount of fine imposed by the division?
- Assuming litigation is an option given local law, what is the anticipated cost of litigation to claw back compensation compared to the amount of the fine?
- Would the attempts to claw back compensation support reduction of fines imposed by regulatory agencies other than the DOJ or the SEC? For example, if the corporate wrongdoing also involved a corporate integrity agreement or a settlement with a foreign regulator, would the other applicable regulators provide reductions to their fines?
- Does there need to be a review of the company's D&O insurance policies and the potential impact of attempted compensation clawbacks? Is there a net financial benefit or detriment in connection with the company's D&O insurance?
- Would the efforts to claw back employee compensation provide any credit or benefit in connection with a parallel action brought by the Office of Inspector General or other regulatory body?

Illustrative Analysis Involving Potential Clawbacks

From a practical perspective, there are also specific financial considerations a company may consider when facing a potential corporate resolution that could provide a reduction in penalties because of clawback efforts.

The following hypothetical example may help illustrate some of the relevant factors.

Our assumptions include:

- A \$25 billion business involved with the allegations of wrongdoing;
- A \$500 million fine levied by a regulator;
- Five employees subject to compensation clawback, who were paid the following \$30 million in total for the periods in question: \$15 million in salary; \$5 million in bonuses; \$4 million in stock-based compensation; \$3 million in nonstock-based compensation; \$3 million in increased value of pension benefits and deferred compensation;

- \$3 million in litigation fees to law firms and experts to identify, value and attempt to claw back the various types and amounts of compensation — though not every situation would require litigation;
- \$1 million in internal costs for the time and effort to claw back compensation; and
- A 50% probability of winning the litigation.

Based on the above assumptions, would a company potentially invest the time and effort to claw back the applicable compensation? To answer this question, the company may want to:

- Analyze the relevant employment contracts and the alleged violative behavior, and identify the scope of compensation that could be subject to clawback;
- Identify the type and value of compensation associated with the actions included in the corporate resolution, which could require some level of causation and valuation analysis; and
- Estimate, validate and gain consensus regarding the duration, extent and probability of success involved with clawing back the estimated amount of compensation in scope.

Putting aside the true complexities in a real situation, in this hypothetical, and without accounting for the time value of money, the estimated risk-adjusted value to the company would be approximately \$13 million — \$30 million total compensation, minus \$3 million in litigation fees, minus \$1 million in internal costs, multiplied by 50% probability of winning the litigation.

The company will now need to decide if the time and effort of clawing back compensation makes business sense.

Although the above calculation is illustrative and does not include many complexities, the strategic, human resources and economic considerations were all likely evaluated by the parties involved in the resolution with Albemarle.

Albemarle's payment of \$218 million included a penalty of approximately \$98.2 million, and the penalty reflected a reduction of \$763,453 for bonuses that the company withheld from qualifying employees.

Based on this resolution, compensation clawbacks appear to be a smaller piece of the overall resolution, but under different circumstances, the impact of the clawback could be greater.

Compliance professions, internal counsel, external counsel and economic experts will likely pay close attention to additional future resolutions to inform corporate compliance decision making.

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[1] <https://www.justice.gov/opa/pr/albemarle-pay-over-218m-resolve-foreign-corrupt-practices-act-investigation>.

[2] <https://www.justice.gov/criminal-fraud/file/1571941/download>; see also,

<https://www.justice.gov/opa/speech/file/1535301/download>.

[3] These are examples provided by the Pilot Program; the Division prosecutors will customize the requirements based on the particular facts, circumstances, and applicable foreign and domestic laws of each case.

[4] <https://www.justice.gov/criminal-fraud/file/1571941/download>, p. 2.

[5] Id.

[6] Id.

[7] <https://aflcio.org/paywatch/highest-paid-ceos>.

[8] The period for which the latest data is available varies by entity.

[9] Three minimum "Stock Awards" and "Option Awards" amounts received by the CEO's was zero.

[10] Id.

[11] The minimum "All Other Compensation" amount received by the CEO's was \$1,500.