

COVID-19: NEW DOJ GUIDANCE ON INABILITY-TO-PAY CLAIMS: WHAT COMPANIES AFFECTED BY COVID-19 NEED TO KNOW WHEN SEEKING REDUCED CIVIL AND CRIMINAL PENALTIES FROM DOJ

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As many corporate practitioners know from experience, U.S. Department of Justice (DOJ) lawyers and federal prosecutors often factor a company's inability to pay into corporate civil and criminal resolutions with the government. More often than not, however, the government's inability-to-pay analysis was applied *ad hoc* and behind closed doors, leaving corporate counsel and other practitioners to draw piecemeal conclusions from non-public resolutions, or make inferences about DOJ policies, or the lack thereof, based on deferred prosecution agreements or settlement agreements.

DOJ recently addressed this uncertainty by publishing two policy memoranda, which are especially topical for companies that have been adversely affected by the COVID-19 pandemic and are facing civil or criminal investigations by DOJ.

Last month, DOJ's Civil Division issued a memorandum (Civil Division Memorandum) outlining factors the Civil Division will consider in assessing a business organization's claim that it is unable to pay a civil monetary penalty.¹ The Civil Division Memorandum follows on the heels of a similar memorandum issued last October by DOJ's Criminal Division (Criminal Division Memorandum)² that addresses resolution of criminal cases. The new memoranda lend transparency, uniformity, and predictability to the formerly opaque inability-to-pay process by clarifying the scope and nature of DOJ's analysis and also provide a much-needed framework that corporate counsel can use to tailor their arguments for a fair resolution consistent with DOJ's expectations.

CIVIL DIVISION MEMORANDUM

For years, the Justice Manual—the authoritative collection of DOJ's internal policy guidance—authorized government attorneys to consider inability to pay as a basis to “compromise or close” a claim involving the United States.³ If the “financial condition of the debtor” creates “real doubt as to the government's ability to collect in full,” among other reasons, the Justice Manual states that settlement may be warranted but leaves unexplained how to make this threshold determination in the first instance.

The Civil Division Memorandum appears to fill much of the gap by outlining seven non-exclusive factors Civil Division lawyers must consider in evaluating whether an entity can assert a meritorious inability-to-pay claim.⁴ Consistent with the Justice Manual's guidelines, the Civil Division Memorandum establishes that

government lawyers may consider an entity's inability to pay if the entity lacks sufficient assets to pay the government and meet ordinary business expenses. The entity bears the burden of proving these conditions and must provide "all information requested by the Civil Division," including, but not limited to, completion of the Civil Division's certified Financial Disclosure Form, "tax returns, audited financial statements, and access to appropriate personnel."⁵ The required disclosures are extensive and will likely be scrutinized by a "qualified financial expert" retained by the government.⁶

CRIMINAL DIVISION MEMORANDUM

The Civil Division's memorandum comes less than a year after a memorandum from DOJ's Criminal Division that sets forth a list of similar factors federal prosecutors will consider when an organization claims that it is unable to pay an otherwise appropriate criminal fine or monetary penalty.

Notably, and in contrast to the Civil Division guidance, before the Criminal Division will consider an organization's inability to pay, the parties must reach an agreement as to the form of the resolution—e.g., non-prosecution agreement, deferred prosecution agreement, or corporate guilty plea—and the appropriate amount for the monetary penalty.⁷ DOJ prosecutors will consider the statutory sentencing factors found at 18 U.S.C. § 3572(a) & (b), relevant sections of the U.S. Sentencing Guidelines, and the Justice Manual's provisions regarding collateral consequences.⁸ Moreover, the organization is required to complete the Inability-to-Pay Questionnaire appended to the Criminal Division memorandum, which seeks eleven different categories of information to determine a company's assets, liabilities, anticipated cash flow, and working capital requirements.⁹

If this analysis reveals that "legitimate questions exist regarding an organization's ability to pay," the Criminal Division Memorandum provides four factors similar to those Civil Division lawyers must examine to determine whether an organization is unable to pay an applicable fine or monetary penalty.¹⁰

If federal prosecutors concur that a company has raised a meritorious inability-to-pay claim, this fact likely will be disclosed in any future settlement. However, it's possible that the government may decide not to publicize specific details about the amount or percentage of the penalty reductions, but the Criminal Division Memorandum provides no guarantees of confidentiality about any aspect of the process.

CONSIDERATIONS FOR CORPORATE COUNSEL IN THE TIME OF COVID-19

DOJ's recent inability-to-pay memoranda are especially instructive for business organizations that have suffered adverse financial impacts as a result of the ongoing COVID-19 pandemic and are facing investigation by DOJ. Both memoranda provide a potential avenue for business organizations to reduce the amount of a civil or criminal penalty and should help focus any negotiation with DOJ lawyers regarding a business organization's financial condition. However, corporate counsel should be mindful that the decision to assert an inability-to-pay claim with DOJ can create significant costs and risk exposure arising from the invasive financial disclosures and review process, which can further exacerbate the adverse effects of COVID-19 on a business under investigation by the government.

In evaluating whether to assert an inability-to-pay claim, corporate counsel should consider the amount and type of information the company will need to disclose and the circumstances under which disclosures will be made. While the Criminal Division Memorandum requires an initial agreement regarding the form of the resolution and

the amount of the monetary penalty before a company can assert an inability-to-pay claim, the Civil Division Memorandum contains no such guardrails.

Accordingly, corporate counsel should weigh carefully the prospect of committing the client to opening up books and records to government lawyers and accounting experts without first having secured an agreement in principle regarding the nature of the resolution or the amount of the potential penalty on the table. Given that raising an inability-to-pay claim will entail significant financial disclosures to the government, corporate counsel should also assess any potential disclosure concerns that may arise for public companies that may be contemplating whether to seek a reduced monetary penalty. And, in the False Claims Act context, corporate counsel should keep in mind that the Civil Division Memorandum is silent as to the procedures that apply when the government has decided not to intervene in the case.

Finally, the Criminal Division Memorandum indicates that in the event of uncertainty about a company's ability to continue as a going concern, or its ability to do so after payment of a criminal fine or monetary penalty, federal prosecutors will consider how, or whether, the company has addressed such issues with its outside auditors *prior* to asserting the inability-to-pay claim.¹¹ As a result, any business organization considering an inability-to-pay claim should keep in mind the antecedent costs that the company can incur before approaching the government and evaluate whether raising the claim is a wise tactical move if the question of the company's viability is less than straightforward. After all, engaging DOJ in an inability-to-pay dialogue provides no guarantee that government attorneys will agree to any reduction, irrespective of the company's disclosures.

FOOTNOTES

¹ Memorandum from Ethan P. Davis, Acting Assistant Attorney General, Civil Division, U.S. Dep't of Justice, to All Civil Division Employees, "Assessing an Entity's Assertion of an Inability to Pay" (Sept. 4, 2020) [hereinafter, Civ. Div. Memorandum], [here](#).

² Memorandum from Brian A. Benczkowski, Assistant Attorney General, Criminal Division, U.S. Dep't of Justice, to All Criminal Division Employees, "Evaluating a Business Organization's Inability to Pay a Criminal Fine or Criminal Monetary Penalty" (Oct. 8, 2020) [hereinafter, Crim. Div. Memorandum], [here](#).

³ Justice Manual § 4-3.200.

⁴ The seven factors are: (1) Background on Current Financial Conditions; (2) Alternative Sources of Capital; (3) Timing of Payments; (4) Tax Deductibility; (5) Contingency Agreements; (6) Collateral Consequences; and (7) Third-Party Liability.

⁵ Civ. Div. Memorandum at 1.

⁶ *Id.* at 2.

⁷ Crim. Div. Memorandum at 1.

⁸ See U.S.S.G. §§ 8C2.2 & 8C3.3; Justice Manual § 9-28.1100.

⁹ Crim. Div. Memorandum, Attachment A. The Questionnaire asks companies to provide documents on eleven topics: (1) recent cash flow projections; (2) operating budgets and projections of future profitability; (3) capital budgets and projections of annual capital expenditures; (4) proposed changes in financing or capital structure; (5)

acquisition or divestiture plans; (6) restructuring plans; (7) claims to insurers; (8) related or affiliated party transactions; (9) encumbered assets; and (10) liens on company assets; and (11) additional materials, including current and prior financial statements, recent federal corporate income tax returns, recent appraisals and valuation studies, copies of current credit and loan agreements, and compensation information for the ten most highly compensated employees in the company.

¹⁰ *Id.* at 3. The four factors are: (1) Background on Current Financial Condition; (2) Alternative Sources of Capital; (3) Collateral Consequences; and (4) Victim Restitution Consideration.

¹¹ *Id.* n.3.

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