

“Clawback Comeback”: DOJ’s New Focus on Clawbacks to Prevent Corporate Crime

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In September 2022, Deputy Attorney General Lisa Monaco delivered [remarks](#) unveiling the Department of Justice’s [revised corporate crime guidance](#) to “prioritize and prosecute corporate crime.” She reiterated that the number one priority for the DOJ is “individual accountability.” To that end, Monaco emphasized that the DOJ will “reward” companies that claw back compensation from executives “when misconduct occurs.” This new focus on “clawbacks” is intended to give general counsels and chief compliance officers the tools to implement “responsible corporate behavior” and to foster a corporate culture that both deters and punishes risky (and possibly criminal) behavior by top executives.

With this focus on executive compensation clawbacks, the DOJ is stepping into an area first highlighted by the Dodd-Frank Act of 2010, which directed the Securities and Exchange Commission to promulgate rules requiring publicly-listed companies to have compensation clawback policies. Twelve years after the passage of Dodd-Frank, the SEC has still not implemented final rules governing clawbacks. However, on June 8, 2022, the SEC requested comments for the third time on its proposed rule, and we expect final rules to be forthcoming.

Some history on clawbacks is useful context for understanding the DOJ approach. Executives can face clawback of previously paid compensation under various circumstances. The difficult issue is determining the reason for clawing back compensation (i.e., was it the result of “fault” or criminal conduct or an accounting mistake) and determining the executive’s “culpability” in securing unjustified compensation. Clawbacks can arise when incentive compensation (annual bonuses or long term equity compensation) pays out on the achievement of financial metrics, such as earnings per share or revenue growth, where the determination that those metrics have been achieved turns out to be incorrect . Errors like this can be due to a range of factors, some implicating an executive’s actions more than others. For example, this can be the result of a misapplication of complicated accounting principles, or inadequate internal controls, or, at worst, actual executive fraud, misconduct, or criminal activity.

The Dodd-Frank Act sought to direct corporate accountability by directing the SEC to require publicly-listed companies to implement compensation clawback policies. To that end, the SEC proposed an expansive rule in 2015 that would have required clawbacks in the event of inaccurate financial statements even in “no fault” situations – for example, an officer’s incentive-based compensation could be clawed back even if there was no misconduct or they bore no responsibility for the inaccuracies in the financial statements. Faced with intense pushback, the SEC did not implement its 2015 proposed rule, although the SEC reopened comment periods in [October 2021](#) and, as noted above, most recently in [June 2022](#). Given the delay in the SEC’s implementation of final rules, public companies have taken various approaches. Some have done nothing while they wait for final SEC action, others have implemented clawback policies relating to accounting restatements, and some have gone further and implemented clawback policies for executive misconduct or criminal activity, and in most cases given the Compensation Committee broad discretion in how to apply such policies. Notably, as part of its reopening of the comment period for the Dodd-Frank Act clawback rules, the SEC Staff [released a memo](#) that included additional analyses regarding the increase in 2015 in voluntary adoption of clawback policies, provided estimates of the number of additional restatements that would potentially trigger a clawback if the rule were expanded to include all required restatements made to correct an error in previously-issued financial statements rather than just restatements to correct errors that are material to previously issued financial statements, and discusses some potential implications for the costs and benefits of the proposed rule.

Viewed in this context, Monaco's call to tie criminal enforcement actions to the existence and application of clawback policies appears to be a signal from the DOJ that they will not wait for the SEC and are willing to encourage market action through their own prosecutorial powers. If Monaco's proposals are implemented through the DOJ's prosecutorial guidelines, corporations that are the target of DOJ criminal action may face less drastic criminal penalties if they have adopted and implemented clawback policies in line with the DOJ's recommendations. Of course, executives involved in criminal conduct could face DOJ criminal action as well as the financial clawback of previously paid compensation. It is unclear from the new policy just how much relief a company subject to a DOJ criminal action would get by adopting and implementing clawback policies – Monaco called on the DOJ's Criminal Division to "develop further guidance" by the end of this year to "reward corporations that develop and apply compensation clawback policies."

The DOJ's revised corporate crime guidance also notes that prosecutors should consider whether a company's compensation system is structured in a manner that provides "affirmative incentives for compliance-promoting behavior," such as by using (i) compliance metrics and benchmarks for compensation calculations and (ii) performance reviews that measure and incentivize compliance-promoting behavior.

Now that the DOJ is focusing on executive compensation, companies should consult with their outside counsel for a multi-disciplinary approach to reviewing, implementing and enforcing clawback and other compensation policies. The issues are complicated, and white collar criminal counsel need to work closely with executive compensation and benefits counsel to fully understand the scope and implications of clawback policies. There are many constituents implicated by a clawback policy: the senior executive team, the board of directors, compensation committee, outside shareholders and shareholder advisory services, to name a few. Companies will also need to consider the SEC, and any final rule it promulgates. To that end, companies will need a coordinated and well-quarterbacked legal approach to maximize protection from DOJ criminal prosecutions through the adoption of clawback policies. Proskauer has a long established coordinated team of white collar and executive compensation attorneys who work together to address these type of issues, and will continue to monitor these developments.

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