United States v. Hynix Semiconductor, Inc.: Opening the Door to the Inability-to-Pay Defense?

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In the high-stakes world of criminal antitrust, practitioners are always watching the U.S. Department of Justice's Antitrust Division for cues about what they should or should not do the next time they have to walk through the Division's door to try to cut the best possible deal for their clients. In May of this year the Division secured the third-largest fine in antitrust history when Hynix Semiconductor Inc. pleaded guilty to fixing the prices of DRAM computer chips and agreed to pay $185 million.

The Hynix plea arose out of the Division's long-running investigation of the DRAM industry, and is the second huge-dollar guilty plea of a computer chip manufacturer to come out of the investigation. The other guilty plea—by Infineon Technologies AG—led to the fourth-largest criminal antitrust fine ever.

With such high stakes involved, the Division was well aware that all eyes in the criminal antitrust bar would be on it. Given that, the Division—as it always is—was cognizant of the precedent its plea agreements create for future negotiations. After all, the Division itself profits from transparency because it knows that if defense counsel can trust that their clients will do better by cooperating early, then it is more likely that they will advise their clients to do so. Indeed, the Division has acknowledged that transparency is one of the three most important factors in an effective enforcement regime, the other two being the threat of severe sanctions and fear of detection.[1]

With the spotlight shining that much brighter in the higher profile cases like DRAM, this is all the more true. That is why the Division's actions in the DRAM investigation could signal lessons about the current mindset of the Division—specifically what factors it will and will not consider in negotiating a plea.

Have there been any lessons for practitioners from the DRAM prosecution so far? Perhaps. The terms of the Hynix plea may indicate that the Division is willing to use with greater frequency the "inability to pay" section of the Federal Sentencing Guidelines to reduce a defendant's fine below the ordinary recommended Guideline fine. It would be helpful, however, for future cases if the Division better articulated its thinking.

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[1] "The third and final hallmark of an effective Amnesty Program is the need for transparency to the greatest degree possible throughout the enforcement program. Self-reporting and cooperation from offenders have been essential to our ability to detect and prosecute cartel activity. Cooperation from violators, in turn, has been dependent upon our readiness to provide transparency throughout our anti-cartel enforcement program so that a company can predict with a high degree of certainty how it will be treated if it reports the conduct and what the consequences will be if it does not." Scott D. Hammond, Deputy Assistant Attorney General, U.S. Dep't of Justice Antitrust Division, Cornerstones of an Effective Leniency Program, Remarks Presented Before the ICN Workshop on Leniency Programs in Sydney, Australia at 9 (Nov. 22–23, 2004), *available at* http://www.usdoj.gov/atr/public/speeches/206611.htm.

Specifically, in imposing Hynix's gigantic, but still significantly decreased, fine, the Division chose to eschew its long-preferred practice of justifying a decreased fine based on the defendant's cooperation. Instead, the Division stated that it had reduced Hynix's fine due to its inability to pay the full amount of its fine as calculated under the Federal Sentencing Guidelines.[2] Using the inability-to-pay provision of the Guidelines would make sense if Hynix clearly met existing requirements for qualifying for such a reduction. But there's the rub: publicly available information suggests that, by the time of its plea, Hynix did not look like a company that needed this particular special break, especially given that it would have gotten a substantial discount anyway based on its cooperation with the Division's investigation. So the Division must have seen an unarticulated "something" that led it to accept the "inability-to-pay" reduction. It would be helpful for the Division to state what that "something" was. Meanwhile, other defendants and their counsel should try to say "me too."

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Prior Application of the "Inability-to-Pay" Criterion

The Federal Sentencing Guidelines impose a stringent test on corporations or other organizations seeking an inability to-pay-discount. Section 8, Part C of the Guidelines provides for the imposition of fines on organizations. Section 8C3.3 is entitled "Reduction of a Fine Based on Inability to Pay" and its subsection (a) states that a "court shall reduce the fine below that otherwise required . . . to the extent that imposition of such fine would impair its ability to make restitution to victims."[3] Subsection (b) allows—but does not require—a court to decrease a fine below the minimum fine, "if the court finds that the organization is not able and, even with the use of a reasonable installment schedule, is not likely to become able to pay the minimum fine [calculated under the Guidelines]. *Provided, that the reduction under this subsection shall not be more than necessary to avoid substantially jeopardizing the continued viability of the organization.*"[4]

Section 8C3.3's Application Note explains that "an organization is not able to pay the minimum fine if, even with an installment schedule under § 8C3.2 (Payment of the Fine—Organizations), the payment of that fine would substantially jeopardize the continued existence of the organization." Consequently, for an entity to qualify for a reduced fine based on its "Inability to Pay," it must prove that the payment of the fine would put its continued existence in jeopardy or affect its ability to make restitution to the victims of the crime.

Case law interpreting the inability-to-pay discount seems to actually tighten the requirements. The Third Circuit, for example, has held that in evaluating the inability-to-pay question, "[t]he sentencing court must take account of the corporate defendant's financial resources, putting the burden on the defendant to produce relevant materials, before setting a fine that *may consume all of the defendant's assets.*"[5]

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[2] United States v. Hynix Semiconductor, Inc., No. CR 05-249 PJH (N.D. Cal.) Plea Agreement ¶10, at 5–6 (Apr. 20, 2005) ("[t]he United States agrees that, based on Defendant's ongoing cooperation, the United States would have moved the court for a downward departure .. . , but for the fact that the amount of the fine that the United States would have recommended ... would still have exceeded Defendant's ability to pay. The parties further agree that the recommended fine is appropriate . . . due to the inability of the Defendant to make restitution to victims and pay a fine greater than that recommended without substantially jeopardizing its continued viability.")

[3] United States Sentencing Commission, Guidelines Manual § 8C3.3(a) (Nov. 2004) [Guidelines Manual].

[4] *Id.* § 8C3.3(b) (emphasis added).

[5] United States v. Nathan, 188 F. 3d 190, 213 (3d Cir. 1999) (emphasis added).

In *United States v. Eureka Laboratories, Inc.*,[6] the Ninth Circuit went so far as to hold that:

> Guideline Section 8C3.3 does not prohibit a court from imposing a fine that jeopardizes an organization's continued viability. It permits, but does not require, a court in such circumstances and in its discretion, to reduce the fine. The only time a reduction is mandated under section 8C3.3 is if the fine imposed, without reduction, would impair the defendant's ability to make restitution to victims. See USSG § 8C3.3(a). Thus, even if the district court's fine would completely bankrupt [Eureka], neither section 8C3.3(a) nor section 8C3.3(b) precluded the court from imposing such a fine so long as the fine did not impair [Eureka's] ability to make restitution. It did not.

The bottom line is that qualifying for an inability-to-pay discount is not easy. And the Division has historically put defendants to the task of clearing these legal hurdles, rarely accepting defendants' claims of inability to pay.

Hynix Did Not Fit the Traditional "Inability-to-Pay" Criteria

What about Hynix? It should have been in really bad shape, i.e., its "continued viability" in jeopardy, to get the discount.[7] Was it?

At first glance, Hynix might have appeared to be a reasonable candidate for the discount. Hynix has long been in serious financial trouble; in fact, it has been controlled by creditors since 2001. There has long been speculation that, in the latter part of 2001, Hynix's competitors initiated a "price war" to try and force Hynix to go under. Following this, it was widely reported that a competitor in the DRAM industry (Micron) all but acquired Hynix in 2002, reaching an agreement in principle, only to see the transaction crater at the eleventh hour.[8] After the Hynix-Micron deal fell through, Hynix needed a $4 billion bail-out in December 2002.[9] Had the plea agreement been reached in 2002, Hynix was an obvious candidate for the inability-to-pay discount.

However, more recently, Hynix has turned the corner in a big way; so much so that Hynix reported operating profit for the fourth quarter of 2004 of roughly $420 million and capital surplus of approximately $500 million.[10] Hynix's operating profit in the first quarter of 2005 was about $320 million.[11] Leading market research analysts report Hynix is aggressively expanding its capital expenditures, and Hynix's own Web site confirms this, reporting that Hynix is spending $250 million in 2005—as an initial investment—on a new factory in China.[12] After Hynix's fine became public, Hynix assured investors in public statements that not only did the $185 million fine not threaten its existence (a goal of the inability-to-pay discount) but would not even hurt its bottom line.[13] And most recently, Hynix reported that it was a year ahead of schedule in paying off its creditors.[14]

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[6] 103 F. 3d 908, 912 (9th Cir. 1996).

[7] Guidelines Manual, *supra* note 3, §8 C3.3(b).

[8] *See Hynix Creditor Claims Major Progress in Micron Talks*, The Register, Mar. 19, 2002, *available at* http://www.theregister.co.uk/2002/03/19/hynix_creditor_claims_major_progress/); *Hynix Ditches Micron Rescue Deal*, BBC News, Apr. 30, 2002, *available at* http://news.bbc.co.uk/1/hi/business/1959309.stm.

[9] *See Rescue Plan for Chip Giant Hynix*, BBC NEWS, Dec. 30, 2002, *available at* http://news.bbc.co.uk/1/hi/business/2614585.stm.

[10] *See Hynix Financial Info*, *at* http://www.hynix.com/eng/04_ir/03_financial/financial_01.jsp.

[11] *See Hynix Semiconductor Inc. Reports the Results for the First Quarter of FY 2005*, May 4, 2005, *at* http://www.hynix.com/allnews/eng/preng_readA.jsp?NEWS_DATE=2005-05-04:13:07:05&CurrentPageNo=1&SearchKind=4&SearchWord=&SELECT_DATE=.

[12] *See* Hynix Press Release (Apr. 28, 2005), *at* http://www.hynix.com/allnews/eng/preng_readC.jsp?NEWS_DATE=2005-05-03:16:05:46.

[13] *See Hynix Says It Can Pay Fine and Still Meet Bottom Line*, Taipei Times, Apr. 23, 2005, at 11, *available at* http://www.taipeitimes.com/News/worldbiz/archives/2005/04/23/2003251657.

[14] *See Hynix Pays Its Debts a Year Early*, BBC News, July 12, 2005, at http://news.bbc.co.uk/1/go/pr/fr/-/1/hi/business/4674245.stm.

What Explains the Deal?

Why, then, would the Division nevertheless extend this unusual discount to Hynix? Could it be as simple as $185 million was just the number that got the deal done and the Division and Hynix used "inability to pay" to justify that number even though it could not have been normally justified using traditional cooperation discounts alone? Is the Division now ready to use an inability-to-pay discount to get fines to a place where defendants can realistically afford them, even if the defendant could not meet the seemingly stringent inability-to-pay requirements? The Division could have eased Hynix's payments by back-loading a small portion of the fine or providing a discount (albeit a lesser discount) based on Hynix's relatively early cooperation in the investigation. This makes it appear that the Division could have used "inability to pay" simply as a way for the two sides to bridge final gaps in their negotiations after they were already close to terms. By using "inability to pay" for Hynix, which had been at least a superficially valid candidate for such a discount, maybe the Division believes it can keep the *cooperation* discount low for other "second-in" cooperators, who lacked Hynix's earlier financial troubles.

If nothing else, the Hynix plea signals that the Division might be more flexible and tolerant of creative solutions to reduce financial burdens on slow-poke defendants.

Consider the circumstances more closely: Hynix agreed to pay $185 million over five years. The Division agreed to accept an initial payment from Hynix of only $10 million. And even better for Hynix, the fine is interest-free. Suffice it to say that a low down-payment and interest-free financing is not how the Division has typically done business in the past. Focusing on the actual fine amount, it appears that the inability-to-pay discount was worth about $16 million, or approximately 8 percent, off the fine. We reached that number by first looking at Hynix's Joint Sentencing Memorandum.[15] Hynix's all-important "volume of affected commerce" was $839 million. Under the Guidelines, that translated into a minimum fine of $268.5 million.[16] Assuming that Hynix would have otherwise received a "standard" third-in cooperator's discount of 25 percent, its fine would have been $201 million.

Would that $16 million—spread out over five years and interest-free—really have jeopardized the continued existence of a company that has hundreds of millions in cash and is set to spend $250 million on an initial payment of a business venture in China? Given today's low interest rates—and yes, the rate is fixed as of the date of the first payment on a fine—would the imposition of interest have broken Hynix's bank or challenged its continued viability? Would it have jeopardized Hynix's China expansion plans or put a dent in its profit projections? We do not think so.

Lessons for the Next Defendant

Because the Division is not required, nor did it volunteer, to explain its reasoning for cutting the deal with Hynix, what does this all mean? We offer these suggestions:

If nothing else, the Hynix plea signals that the Division might be more flexible and tolerant of creative solutions to reduce financial burdens on slow-poke defendants. After all, each additional cooperator helps the Division's efforts to put the squeeze on the remaining conspirators. Perhaps, Hynix got the $185 million deal done playing the "inability-to-pay" card because the Division did not want to offer any greater substantial assistance discount percentage, fearing that it will negatively impact their fine negotiating position in other matters. Maybe this new-found flex-

[15] United States v. Hynix Semiconductor, Inc., No. CR 05-249 PJH (N.D. Cal.), Joint Sentencing Memorandum at 5 (May 4, 2005).

[16] *Id.*

ibility is just an outgrowth of *Booker*[17] and *Blakely*[18] and the Guidelines' new quasi-advisory status under those cases.

Certainly defense attorneys should all take the time and effort to review their clients' financial statements, loan covenants, and future/projected cash flow to analyze—under the Hynix "standard"—whether there is an inability-to-pay opportunity, even a marginal one. Maybe there is even a new role for the financial analyst in Division cases. Clouding your client's financial picture may just have a silver lining. If nothing else, counsel should work hard to estimate "worst-case" civil damage exposure as a way to see if the Division is willing to take a haircut on its fine, such as it appears to have done with Hynix.

Given the primacy the Division places on transparency in its sentencing regime and assuming that there is, in fact, a message sent with the Hynix "inability-to-pay" sentence, the Hynix plea must be interpreted as a sign that the Division will listen, and apparently listen hard, to an inability-to-pay argument. But is the door only open a crack? Is this a sign that the Division is going to be more flexible in other areas too?

Whatever the answers to those questions, it is possible to take away the impression that the Division is willing to cut deals that make room for the conspirators who see the sense in cooperating a little later than the lucky criminal who beats everyone else to the Division's door. Over time, case-by-case prodding of the Division, or a fuller public statement of the Division's reasoning, will flesh out the answers to these questions. In the meantime, take out your calculator and look at it through your crystal ball—do you see your client's "inability to pay," even just a little bit? ●

[17] United States v. Booker, 125 S. Ct. 738 (2005).

[18] Blakely v. Washington, 542 U.S. 296 (2004).