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CORPORATE CRIME LEGISLATION: A POLITICAL ECONOMY ANALYSIS

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CORPORATE CRIME LEGISLATION: A POLITICAL ECONOMY ANALYSIS

By: V. S. Khanna*

Abstract

Corporate crime has once again become an important issue on the US legislative agenda leading Congress and the various regulatory bodies to tighten the law and enhance honesty and completeness in disclosure. However, the continued and rather explosive growth of corporate crime legislation leaves one with a rather strange puzzle: how can such a state of the world arise? After all, corporations and business interests are considered some of the most, if not *the* most, powerful and effective lobbyists in the country. Yet, we witness the continued expansion of legislation that criminalizes their behavior (one estimate suggests over 300,000 federal regulatory offenses that can be prosecuted criminally). How could this have happened? This paper sets out to answer this puzzle.

An answer is important not only for understanding the political dynamics of current regulation, but also because it provides insights into the effectiveness of our current approach for regulating corporate wrongdoing. Overall, my analysis suggests that most corporate crime legislation arises at times when there is a large public outcry over a series of corporate scandals during or around a downturn in the economy. In such a situation Congress must respond and corporate crime legislation may be the preferred response for some corporate interests. This is because it satisfies the public outcry while imposing relatively low costs on corporate interests, avoiding legislative and judicial responses that are more harmful to their interests, and sometimes helping to deflect criminal liability away from managers and executives and on to corporations. This explains not only the impressive growth of corporate crime legislation, but also leads to some surprising normative conclusions. In particular, it leads to the counter-intuitive result that if one starts with the view that there is *under-deterrence* of corporate wrongdoing then one would probably prefer to *reduce* corporate criminal liability and focus more on corporate civil liability and managerial liability.

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I. INTRODUCTION

Corporate crime is back in the news.¹ The last two years have seen some of the most spectacular revelations of corporate wrongdoing in US history.² Corporations in virtually all major fields of business have been implicated in what amounts to large scale frauds.³ The drain on the US economy has been staggering with many stock indices losing a significant portion of their value.⁴ This has led Congress and the various regulatory bodies to tighten the law and enhance honesty and completeness in disclosure.⁵ As an example, consider the large increase in penalties that executives and others may suffer under the Sarbanes-Oxley Act of 2002.⁶ This new law adds to the already sprawling area of

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¹ See, e.g., Lee Walczak & Richard S. Dunham, *Corporate Crime: Why It's Not Sticking to Republicans*, BUS. WK., October 7, 2002, at 57 (referring to a "corporate crime wave," starting with the Enron collapse); Daniel Eisenberg, *More Reform and Less Hot Air*, TIME, July 22, 2002, at 24.

² A total of 238 organizations were fined or required to pay restitution in the 2001 fiscal year. See UNITED STATES SENTENCING COMMISSION ANNUAL REPORT: Table 51, available at <http://www.uscc.gov/ANNRPT/2001/table51.pdf> (last visited Nov. 1, 2002).

³ See *id.*

⁴ Between August 2001 and August 2002, the Nasdaq lost 29% of its value; dropping from approximately \$2,688,686,785 to \$1,921,970,173 (in thousands). The three markets combined (Nasdaq, NYSE, and Amex) lost 16% of their value between August 2001 and August 2002. See Comparing Three Markets: NASDAQ, NYSE & Amex, available at <http://marketdata.nasdaq.com/asp/Sec1Summary.asp> (last visited Nov. 1, 2002).

⁵ See generally Public Accounting Reform and Investor Protection Act of 2002, Pub.L. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C.A and 18 U.S.C.A.).

⁶ See *id.* §305. The Sentencing Guidelines have also been recently amended to reflect the directives in Sarbanes-Oxley. See UNITED STATES SENTENCING COMMISSION REPORT TO THE CONGRESS: INCREASED PENALTIES UNDER THE SARBANES-OXLEY ACT OF 2002, (Jan. 2003), http://www.uscc.gov/r_congress/S-Oreport.pdf. See generally UNITED STATES SENTENCING GUIDELINES §8 (1995)[hereinafter SENTENCING GUIDELINES].

corporate criminal liability.⁷ With all these measures being debated and enacted, sometimes rather quickly, it seems to be an appropriate time to think more broadly about how we might regulate behavior in the corporate sphere to prevent or deter the kinds of wrongdoing we have witnessed in the recent past.

Indeed, legal scholarship has examined a number of important aspects of corporate criminal liability,⁸ however there still remains a largely unanswered fundamental question: how is there so much corporate crime legislation *given* that it targets groups (corporate interests) that should be quite good at lobbying against criminalization of their behavior?⁹ This paper addresses this question and examines the surprising normative implications arising from it.

When surveying the terrain of corporate crime legislation one of the first things that strikes the observer is the sheer magnitude of it. Even before the recent spate of scandals the number of criminal offenses for which a corporation could be convicted was estimated to be over 300,000 at the Federal level alone.¹⁰ In addition, this number has been increasing rapidly as corporate crime legislation continues to be enacted at breathtaking speed.¹¹ This, however, seems

⁷ See John C. Coffee, Jr., *Does Unlawful Mean Criminal?: Reflections on the Disappearing Tort/Crime Distinction in American Law*, 71 B.U.L.REV. 193, 216 - 19 (1991). For a flavor of the breadth of corporate criminal liability see RICHARD S. GRUNER, *CORPORATE CRIME AND SENTENCING* §9.7, at 553 - 84 (discussing fines in the antitrust, environmental, and food and drug arenas), §9.5.5, at 551 - 52 (discussing fines for money laundering and related offenses) (1994).

⁸ See, e.g., John C. Coffee, Jr., "No Soul to Damn, No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment, 79 MICH. L. REV. 386 (1981); Jennifer Arlen & Reinier Kraakman, *Controlling Corporate misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U.L.REV. 687 (1997) (discussing corporate liability regimes); Brent Fisse, *Reconstructing Corporate Criminal Law: Deterrence, Retribution, Fault, and Sanctions*, 56 S. CAL. L. REV. 1141 (1983) (arguing that retribution and deterrence are two primary goals of corporate criminal law); Lawrence Friedman, *In Defense of Corporate Criminal Liability*, 23 HARV. J. L. & PUB. POL'Y 833, 833 (2000) (stating that "even in the corporate context, moral condemnation remains a valid aim of the criminal law"); V.S. Khanna, *Corporate Criminal Liability: What Purpose Does it Serve?*, 109 HARV. L. REV. 1477 (1996) [hereinafter *Corporate Criminal Liability*] (discussing corporate criminal liability compared to other liability strategies and concluding that corporate criminal liability is rarely desirable); V.S. Khanna, *Is the Notion of Corporate Fault a Faulty Notion?: The Case of Corporate Mens Rea*, 79 B.U.L.REV. 355 (1999) [hereinafter *Corporate Fault*] (discussing the incentive effects of corporate fault standards); Vikramaditya S. Khanna, *Should the Behavior of Top Management Matter*, forthcoming 91 GEO.L.J. (2003) [hereinafter *Top Management*] (arguing that the current setting of corporate sanctions relying on the involvement of top management in wrongdoing needs refinement); William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 52 VAND. L. REV. 1343 (1999); Joseph Vining, *Corporate Crime and the Religious Sensibility*, 5 PUNISHMENT & SOCIETY 313 (2003).

⁹ Few papers address the political dynamics of corporate crime legislation in much depth. See Jeffrey S. Parker, *Rules without...: Some Critical Reflections on the Federal Corporate Sentencing Guidelines*, 71 WASH. L. U. Q. 397 (1993).

¹⁰ See Coffee, *supra* note 7, at 216 & n.94 (noting that "there are over 300,000 federal regulations that may be enforced criminally" as estimated by Stanley Arkin, "a well known practitioner in the field of white collar crime, at the George Mason Conference in October 1990" and citing to Leary, *The Commission's New Option That Favors Judicial Discretion in Corporate Sentencing*, 3 FED. SENTENCING REP. 142, 144 n.10 (1990)).

¹¹ See Jennifer Arlen, *The Potentially Perverse Effects of Criminal Corporate Liability*, 23 J. LEGAL STUDIES 833, 833 - 34 (1994). Whenever corporate wrongdoing reaches a peak there are usually many moves to increase liability for executives, corporations, and related parties (e.g., accountants and attorneys). See

puzzling because we would normally expect that well organized and well-funded groups (such as corporations) should obtain a large measure of what they want through legislation, yet in the context of corporate crime legislation the corporations seem to be losing the battle.¹² What might explain this rather strange result?

Answering this question is important not only for understanding the political dynamics of our current state of regulation, but also because it provides insights into the effectiveness of our current approach for regulating corporate wrongdoing. Overall, my analysis suggests that most corporate crime legislation arises at times when there is a large public outcry over a series of corporate scandals during or around a downturn in the economy. In such a situation Congress must respond and corporate crime legislation may be the preferred response for some corporate interests because it satisfies the public outcry while imposing relatively low costs on those corporate interests, avoiding legislative and judicial responses that are more harmful to their interests, and sometimes helping to deflect criminal liability away from managers and executives and on to corporations. In these respects corporate crime legislation is a substitute for other responses that are less favored by certain corporate interests. I call this the substitution theory of corporate crime legislation. With weak corporate opposition to corporate crime legislation its growth becomes more understandable as a political matter. Furthermore, my analysis leads to some surprising normative conclusions. In particular, it leads to the counter-intuitive result that if one starts with the view that there is *under-deterrence* of corporate wrongdoing then one would probably prefer to *reduce* corporate criminal liability and focus more on corporate civil liability and managerial liability.

Part II examines the primary legal doctrine used to hold corporations liable for the acts of their agents, discusses the impressive breadth of corporate

Michael Orey, *WorldCom-Inspired 'Whistleblower' Law Has Its Weaknesses*, WALL ST. J., October 1, 2002, at B1; Krissah Williams, *A Two-Way Race to Certify Financial Statements: Executives Scramble to Comply As Regulators Puzzle Over What to Do About Laggards*, WASH. POST, August 13, 2002, at 2002 (discussing corporate reactions to the recently enacted Sarbanes-Oxley Act, corporate reform legislation enacted in the wake of numerous corporate misconduct scandals). See also Coffee, *supra* note 7, at 241 - 42 (1991) (discussing the criminal legislation process, sometimes as a "hasty response to a perceived crisis"); Mark Roe, *Backlash*, 98 COLUM. L. REV. 217 *passim* (1998).

¹² For a discussion of lobbying and rent-seeking see generally JAMES M. BUCHANAN, ROBERT D. TOLLISON & GORDON TULLOCK (EDS), *TOWARDS A THEORY OF A RENT-SEEKING SOCIETY* (1980). There are a number of papers that examine regulation from the perspective of political economy. For a sampling see Laura N. Beny, *The Political Economy of Insider Trading Legislation and Enforcement: International Evidence*, Discussion Paper No. 348, John M. Olin Center for Law, Economics & Business, Harvard Law School 2002, available at http://www.law.harvard.edu/programs/olin_center; Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J.ECON. 371 (1983); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Roe, *supra* note 11; Mark Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000). See also Keith N. Hylton & Vikramaditya S. Khanna, *Toward an Economic Theory of Pro-Defendant Criminal Procedure*, B.U.S.L. Working Paper No. 01-02, 7 (2002), available at <http://www.bu.edu/law/faculty/papers>.

crime legislation at present, and provides some clarifications to the scope of my analysis. From this brief overview we are presented with a basic question: What political dynamics might explain the vast amount of corporate crime legislation? To examine this question it is important to get a sense of the incentives of the various players that shape such legislation. Parts III through VI engage in this task by focusing on the incentives of corporate interests, legislatures, prosecutors, judges, victims, defendants, and the general public. I begin in Parts III and IV by examining the incentives of corporate interests because their lobbying (and other influence) activities are quite important. I argue that there are reasons to believe that some corporate interests may support, or not actively oppose, corporate crime legislation. In particular, during times of a large public outcry for regulation corporate interests may prefer corporate crime legislation because it imposes relatively low costs on certain corporate interests, helps avoid legislative and judicial responses that are more harmful to them, and it may help in some instances to deflect criminal liability away from managers and executives and on to corporations. In these respects corporate crime legislation may be seen as a substitute for other responses that are less favored by many corporate interests.

Part V examines what impact weak corporate opposition has on the incentives of other key players. It appears that when corporate opposition is weak then legislators and prosecutors have strong incentives to favor expansion of criminal liability for corporations as well. This would provide an explanation for why corporate crime legislation seems to be growing at such breakneck speed. Part VI examines other explanations for the growth of corporate crime legislation as well as refinements to the analysis and concludes that the primary findings of this paper remain in tact.¹³

Part VII then examines the surprising normative implications of my analysis. Specifically, my analysis suggests that if one thought corporate wrongdoing was currently under-deterred then one would be inclined to *reduce* corporate criminal liability and focus more on managerial liability and corporate civil liability. Part VIII concludes.

II. CORPORATE CRIMINAL LIABILITY: AN INTRODUCTION

In the US, at both the Federal level and in many states, the primary method of holding corporations liable for the behavior of their agents is *respondet superior*.¹⁴ This requires that the agent be acting “within the scope of

¹³ I hasten to add that these political accounts do not reflect the reasons for the initial development of corporate criminal liability, which grew to fill enforcement gaps. These accounts do provide explanations for the growth of corporate crime legislation when the initial enforcement gaps are no longer relevant.

¹⁴ See RESTATEMENT (THIRD) OF AGENCY §2.04 (2000); Khanna, *Corporate Fault*, *supra* note 8, at 369 – 70 (citing: GRUNER, *supra* note 7, § 3.4.2, at 198 – 203, § 4.1-.2, at 263 – 84).

employment” and with some intent to benefit the corporation.¹⁵ Liability attaches to the corporation regardless of whether the agent was a regular employee or a high level corporate officer, and applies to both civil and criminal liability for corporations.¹⁶ Furthermore, agent liability may depend on the agent possessing *mens rea*, but that is not necessary for liability against the corporation.¹⁷ The corporation can be held liable based on the collective knowledge of the employees as a group rather than just the knowledge of one employee.¹⁸ Thus, corporate liability is very broad and any corporate agent’s behavior could trigger liability for the corporation and for that agent.

The breadth of this liability is reflected in the vast amount of corporate behavior that is subject to criminal penalties. Corporations and their agents can be held criminally liable for violations of the environmental laws,¹⁹ securities laws,²⁰ banking laws,²¹ antitrust laws,²² anti-bribery laws,²³ and a host of other

In states that follow the Model Penal Code (MPC), not *respondent superior*, corporate responsibility for *mens rea* offenses usually requires the involvement of a high level corporate official, not simply any agent. See MODEL PENAL CODE § 2.07(1)(c)(1985); William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 52 VAND. L. REV. 1343, 1384 – 85 (1999) (discussing “substantial authority” under the Model Penal Code); Anthony Ragozino, *Replacing the Collective Knowledge Doctrine with a Better Theory for Establishing Corporate Mens Rea: The Duty Stratification Approach*, 24 SW. U. L. REV. 423, 449 (1995). The MPC approach is in the minority in the US and is not followed at the Federal level and as such I will not discuss it in any greater depth at this time. Similarly, in some overseas jurisdictions corporate criminal liability can only be imposed if the “alter ego” or some group (or person) of considerable importance in the corporate structure was involved in the wrongdoing. See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1490. It is noteworthy that few countries have corporate criminal liability and those that do have a much more restrained version of it compared to the US. See *id.* at 1488 – 91. For a brief discussion of potential explanations for this see *infra text accompanying notes 221 - 225*.

¹⁵ See Khanna, *Corporate Fault*, *supra* note 8, at 370 (citing: *Developments in the Law – Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1247 (1979)); Lewis A. Kornhauser, *An Economic Analysis of the Choice Between Enterprise and Personal Liability for Accidents*, 70 CAL. L. REV. 1345, 1349 (1982).

¹⁶ See *Developments in the Law – Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1247 (1979). Note that respondeat superior liability is in addition to any personal liability that may attach to the agent. See RESTATEMENT (THIRD) OF AGENCY Ch. 11 To. 3 Gen. Matls. (1958 App.) Appendix Court Citations (Respondeat Superior does not defeat agent liability); Khanna, *Corporate Fault*, *supra* note 8, at 370 (citing: KATHLEEN F. BRICKEY, CORPORATE CRIMINAL LIABILITY, §401, at 130 (2d ed., 1992); GRUNER, *supra* note 7, §3.4.2, at 199 – 200).

¹⁷ See GRUNER, *supra* note 7, §4.1 at 263 – 67.

¹⁸ See *id.*

¹⁹ See *e.g.* Clean Air Act, 42 U.S.C. §§ 7401-7671 (2000); Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1387 (2000); Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. §§ 9601 – 9675 (2000).

²⁰ See *e.g.* Securities Act of 1933, 15 U.S.C. § 77a; Securities Act of 1934, 15 U.S.C. §§ 78a-78k; Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 - 80a-64; Public Accounting Reform and Investor Protection Act of 2002, Pub.L. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C.A and 18 U.S.C.A.) (commonly known as Sarbanes-Oxley).

²¹ See Financial Institutions Reform Recovery and Enforcement Act, 12 U.S.C. § 1818 (u) (1988 & Supp. V 1993); Right to Financial Privacy Act of 1978, 12 U.S.C. §§ 3401 – 3422 (1988 & Supp. V 1993); Federal Deposit Insurance Corporation Improvement Act, 12 U.S.C. § 1831o(k) (1988 & Supp. V 1993).

²² See The Sherman Act, 15 U.S.C. § 1, (LEXIS L. Publg. 2003); The Clayton Act, 15 U.S.C. § 17 (1999); The Hart-Scott-Rodino Act, 15 U.S.C. § 18a (2000).

laws.²⁴ This has led to a vast amount of potential criminal liability for corporate behavior. Indeed, some estimates suggest that even prior to the recent events of corporate wrongdoing there were over 300,000 federal offenses that could be prosecuted criminally.²⁵

The magnitude of criminal liability for corporate behavior raises many interesting questions, but the one that will occupy this paper is a political one. How is it that there is so much corporate crime legislation given that it targets groups (corporate interests) that should be quite good at lobbying against criminalization of their behavior?

Before delving into this question a few matters are worth clarifying. First, my discussion is not meant to suggest that corporate interests are a unified interest group. There is a rich and deep public choice literature arguing that regulation is often the result of lobbying battles *between* different business interests so that some business interests are benefited by regulation and others are harmed.²⁶ For example, some regulations may operate as barriers to entry to an industry because they impose costs on doing business that have a larger impact on newer and smaller firms in that industry than on the established incumbents.²⁷ Such arguments provide strong explanations for regulation more

²³ See Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78m(b), (d)(1), (g)-(h), 78dd-2, 78ff (1994); Bribery of Public Officials, 18 U.S.C. § 201 (1982).

²⁴ See Currency Transaction Reporting Act, 31 U.S.C. § 5313 (1994); 18 U.S.C. § 371 (1994) (conspiracy against the United States); 18 U.S.C. § 4 (1994) (fining whoever knows of the commission of a felony and conceals this information or does not report it in a prompt fashion).

²⁵ See Coffee, *supra* note 7, at 216 & n.94 (noting that “there are over 300,000 federal regulations that may be enforced criminally” as estimated by Stanley Arkin, “a well known practitioner in the field of white collar crime, at the George Mason Conference in October 1990” and citing to Leary, *The Commission’s New Option That Favors Judicial Discretion in Corporate Sentencing*, 3 FED. SENTENCING REP. 142, 144 n.10 (1990)).

²⁶ This is a vast literature. For a flavor see generally Becker, *supra* note 12; David Haddock & Jonathan Macey, *Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation*, 30 J.L. & ECON. 311 (1987); Kyle D. Logue, *If Taxpayers Can’t be Fooled, Maybe Congress Can: A Public Choice Perspective on the Tax Transition Debate*, 67 U. CHI. L. REV. 1507 (2000); Michael T. Maloney & Robert E. McCormic, *A Positive Theory of Environmental Quality Regulation*, 25 J.L.ECON. & ORG’N 99 (1982); Peltzman, *supra* note 12; Carlos D. Ramirez & Christian Eigen-Zucchi, *Why Did the Clayton Act Pass? An Analysis of the Interest Group Hypothesis*, Draft 2003 (on file with author); Richard L. Revesz, *Federalism and Environmental Regulation: A Public Choice Analysis*, 115 HARV. L. REV. 553 (2001); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. 3 (1971).

²⁷ See Randall S. Kroszner & Thomas Stratmann, *Interest Group Competition and the Organization of Congress: Theory and Evidence from Financial Services Political Action Committees*, 88 AM. ECON. REV. 1163 (1998); Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward A Synthesis*, 6 J.L. ECON. & ORG’N 167 (1990); Maloney & McCormic, *supra* note 26, at 100 – 06; Sharon Oster, *The Strategic use of Regulatory Investments by Industry Sub-Groups*, 20 ECON. INQUIRY 604, 604 (1982); Peltzman, *supra* note 12; Stigler, *supra* note 12. Similar arguments can be made for other kinds of regulation that increase the costs of doing business. See Revesz, *supra* note 26 (discussing a variety of explanations for environmental regulation such as barriers to entry, economies of scale, differential costs of regulation, gains to producers of environmental equipment, and regional comparative advantage – all of which are premised on the regulation imposing costs on some groups that benefit other groups of business interests). See also discussion *infra* notes 201 and 209.

generally, but my interest is in examining corporate crime legislation. Thus, I discuss incentives *with respect to* corporate crime legislation. I focus on the incentives of groups that would normally oppose regulation (I refer to them as “corporate interests” for expositional ease) and argue that these groups may often prefer corporate crime legislation over increases in corporate civil liability for reasons identified in Parts III and IV of this paper.²⁸ I return to examine some of the issues raised by the battles between corporate interest groups in Part VI.A., and conclude that they do not alter the primary conclusions of this paper.²⁹

Second, the focus of this paper is corporate crime *legislation*. Most of the criminal liability that corporations face in the US stems from Congressional Statutes. However, the initial growth of corporate criminal liability was devoted to the simple crime of public nuisance. The analysis of the initial growth of corporate criminal liability is motivated by different factors than the later, largely legislative, growth of corporate criminal liability.

Let us consider the earliest cases of corporate criminal liability. These cases date back to the 1600s in England and involved instances of public harms (e.g., public nuisances) which municipalities had the duty to prevent or clean up.³⁰ For such harms private enforcement was unlikely because few people would have the incentive or the information to pursue the case.³¹ Public enforcement was then needed and at that time the primary form of public enforcement was criminal liability.³² In addition to needing public enforcement, one also needed liability against the municipality (i.e., corporations) to maintain deterrence because individuals responsible for the public nuisance were either

²⁸ The corporate interest groups who oppose regulation may vary depending on the regulation at issue – specifically who does it hurt most. My reference to corporate interest groups who normally oppose regulation means those corporate interest groups, in a particular context, that would oppose regulation generally. Correlatively, the groups that normally favor increases in regulation may prefer increases in corporate civil liability, rather than corporate crime legislation. However, these groups may find it difficult to vociferously lobby against criminal liability when they lobby in favor of increases in civil liability.

²⁹ I should note that the primary focus of my analysis is on examining the behavior of corporate interest groups with respect to corporate crime legislation and I focus on their interests rather than whether corporate crime legislation is in the public interest (i.e., normatively desirable). Nonetheless, my analysis does have significant and surprising normative implications, which I discuss in Part VII. My discussion also does not delve in depth into theories behind the administrative process underlying these laws and whether, and when, it may tend towards the public interest. For excellent discussions of this and related matters see Steven P. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 98 COLUM L. REV. 1 (1998); Steven P. Croley, *Public Interested Regulation*, 28 FLA. ST. U. L. REV. 7 (2000).

³⁰ See L.H. LEIGH, *THE CRIMINAL LIABILITY OF CORPORATIONS IN ENGLISH LAW* 16 – 18 (1969); Brickey, *supra* note 16.

³¹ See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1486 n. 45 (referring to Brickey, *supra* note 16, at 421 – 22).

³² See Graham Hughes, *Administrative Subpeonas and the Grand Jury: Converging Streams of Criminal and Civil Process*, 47 VAND. L. REV. 573, 587 n.37 (1994) (stating that it was only in the late 1800s that agencies developed civil enforcement and information gathering powers).

very difficult to identify or judgment proof.³³ Corporate criminal liability then provided the only available method for combining public enforcement and corporate liability and hence served a useful enforcement function.³⁴ Indeed, for the first 200 – 250 years of its existence corporate criminal liability grew mainly to fill such gaps and was largely contained to only a few areas.³⁵

However, by the early 1900s public civil enforcement was a realistic alternative and by the 1960s public civil enforcement had the same (and sometimes greater) information gathering powers as public criminal enforcement.³⁶ Somewhat ironically most of the growth of corporate crime legislation occurred when public civil enforcement was a realistic alternative and hence when corporate criminal liability's enforcement rationale was small or non-existent.³⁷ It is this later, and much more dramatic, growth that I am interested in examining in this paper, not the initial development of corporate criminal liability.

A third matter worth clarifying is that there is little special legislation singling out corporations to be subjected to criminal penalties.³⁸ Rather, criminal legislation is generally enacted that applies to “persons” engaged in certain activities and then “person” is defined to include natural persons (i.e., humans) and corporate persons.³⁹ What might this mean for the manner in which corporations lobby?

I doubt that this would significantly impact the *fact* that corporations lobby, it may, however, affect the *manner* of their lobbying. For example, as a general matter if corporations find corporate criminal liability very costly they will probably lobby against it.⁴⁰ As this liability is not found in specific statutory

³³ See James R. Elkins, *Corporations and the Criminal Law: An Uneasy Alliance*, 65 KY. L.J. 73, 82 – 84 (1976) (noting identifiability concerns); Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1480 – 86.

³⁴ See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1486 nn. 53 & 54.

³⁵ See Brickey, *supra* note 16, at 410 – 414; Elkins, *supra* note 33, at 90 – 96; Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1480 – 84.

³⁶ See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1520 – 31.

³⁷ See *id.* at 1487 – 88.

³⁸ Cf. GRUNER, *supra* note 7, at §3.3, at 179 – 95.

³⁹ See HERBERT L. PACKER, *THE LIMITS OF THE CRIMINAL SANCTION* 361-62 (1968); John T. Byam, *The Economic Inefficiency of Corporate Criminal Liability*, 73 J. CRIM. L. & CRIMINOLOGY 582, 583 (1982). This suggests that corporate criminal liability is something of an “after-thought” or an “add-on”. See PACKER, *supra*, at 361 – 62; Byam, *supra*, at 583.

⁴⁰ Corporations may also lobby against enforcement of corporate crime legislation or attempt to cut off budgetary funding for it (see *infra* Part III.B & C). Cf. WILLIAM N. ESKRIDGE & PHILIP P. FRICKEY, *CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY* 37 – 94 (1988); Daniel C. Richman, *Federal Criminal Law, Congressional Delegation, and Enforcement Discretion*, 46 U.C.L.A. LAW REV. 789-810 (1999) [hereinafter *Delegation*]. Indeed, one reason corporations may favor corporate criminal liability (or public enforcement) over civil liability (or private enforcement) is because lobbying may occur with respect to enforcement budgets largely out of sight of the general public. Cf. See Jeffrey Toobin, *Why America's C.E.O.s hate Bill Lerach*, THE NEW YORKER, 09 Sept. 2002, at 9. On the complexity of corporate

wording we might expect that corporations would lobby against the criminalization of the behavior at issue for any “person” (organization or human). Alternatively, they might not lobby against the criminalization of such behavior, but rather lobby for provisions or rules that make it harder to attach criminal liability to the corporation. For example, a carve out of some kind that made it more difficult to hold corporations criminally liable while leaving the criminal law unchanged for others.⁴¹ Given that the general public is unlikely to pay close attention to the exact wording of the statute (due to collective action concerns) such a strategy may be successful.⁴² Thus, just because there is little specific legislation imposing criminal penalties on corporations does not mean that corporations cannot lobby against corporate criminal liability, find carve outs for themselves, or otherwise mitigate its effects *if they so desire*. The real question is why do we not see these kinds of carve outs more and why is there so much potential criminal liability for corporations. As I will suggest in the Parts to follow it is not clear that corporate criminal liability is the worst thing for corporations.⁴³

III. THE POLITICAL PUZZLE OF CORPORATE CRIME LEGISLATION AND THE SUBSTITUTION THESIS.

To analyze the political dynamics of corporate crime legislation it is important to recognize that the politics of criminal law (street or white collar) is a story of institutional politics – that is the politics of the institutions, and their

wrongdoing see, e.g., Susan P. Shapiro, *The Road not Taken: The Elusive Path to Criminal Prosecution for White Collar Offenders*, 19 LAW & SOC'Y REV. 179 (1985); Richman, *Delegation*, *supra*, at 776 – 79.

⁴¹ Safe harbors that are common in the securities regulation field are an example of achieving a carve out. Note that I am not necessarily suggesting that the safe harbors in the securities field are examples of corporate lobbying to obtain carve outs as opposed to simple well intentioned and thought out moves by the SEC. Rather, I am suggesting that the use of something like a “safe harbor” could provide a method of achieving a carve out.

⁴² See *infra* Part V.A.

⁴³ Also one final note about how corporate criminal liability comes to be imposed on corporations at the federal level. Only the US Department of Justice (DoJ) can initiate criminal proceedings against corporations at the federal level. The DoJ can initiate cases on its own motion, but in practice most cases come to the attention of the DoJ through referrals for criminal prosecution from other government agencies engaged in various aspects of law enforcement (e.g., the SEC, EPA) or through private parties (e.g., qui tam suits under the False Claims Act 1986, victims in antitrust suits). Thus, the pattern of corporate crime enforcement is determined in measure by the activities of the DoJ, various other government bodies and private entities as well. One might imagine that this would complicate the analysis of political incentives a great deal because we have so many players. Although clearly the various participants may have different interests and motivations that does not change the fact that no prosecution can be initiated unless the DoJ initiates it. The other enforcement agencies and private players clearly may influence how and when the DoJ or the state prosecutors become aware of cases, but given the somewhat overlapping nature of public civil and private civil enforcement one does not expect that too many cases that have some political support for going criminal will not be brought to the attention of the DoJ. See generally JAMES EISENSTEIN, COUNSEL FOR THE UNITED STATES (1978); Robert L. Rabin, *Agency Criminal Referrals in the Federal System: An Empirical Study of Prosecutorial Discretion*, 24 STAN. L. REV. 1036 (1972).

players, in the criminal context.⁴⁴ It is then important to set out the likely incentives of the important players and how they tend towards expansion of corporate crime legislation. These players include Congress, Management, Corporations, Prosecutors, Judges, and the General Public and Victims of Crime.⁴⁵ My analysis suggests that, somewhat surprisingly, most of the important players, *including many corporations and management*, have reasons to support some corporate crime legislation. This goes a long way towards explaining its growth.

I begin by addressing the likely incentives of corporations and executives with respect to corporate crime legislation. The reason for this is that these players are often perceived to be very effective and powerful lobbyists, yet most corporate crime legislation targets them. This seems like something that merits investigation early on.⁴⁶ My primary argument is that most corporate crime legislation works, in a variety of ways, as a substitute for other measures that are less favored by corporate interests. This substitution thesis, I argue, explains the apparent lack of, or weak opposition to, corporate crime legislation. In particular, I suggest that at times when Congress must, as a political matter, regulate corporate behavior some corporate interests may consider corporate crime legislation a preferred substitute to enhancements in corporate civil liability and, at times, a preferred substitute to managerial liability and sanctions. This analysis leads to some intriguing normative implications, which I discuss later in the paper.

However, to begin the analysis it is necessary to obtain a sense of how most corporate crime legislation comes to be enacted. The normal pattern of corporate crime legislation is that it comes on the heels of a large public outcry for greater regulation following the revelation of a number of events of corporate wrongdoing usually during or around a weak economy.⁴⁷ This was the case for

⁴⁴ See generally William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 MICH. L. REV. 505 *passim* (2001).

⁴⁵ *Cf. id.* I have not listed some other potential players such as federal investigative agencies (FBI, SEC, EPA), the police, defense attorneys and perhaps others. This is largely for analytical simplicity. For a discussion of how some of these players may interact see Daniel C. Richman, *Prosecutors and their Agents, Agents and Their Prosecutors*, 103 COLUM. L. REV. 749 (2003)[hereinafter *Agents*]. One suspects that the federal civil agencies would probably not oppose expansion of criminal liability for corporations because it does not impinge on their ability to bring civil suits. Further, the possibility of being able to refer a case for criminal prosecution might be a nice bargaining chip for a federal agency to possess when dealing with corporations and especially managers.

⁴⁶ This suggests that we need an answer for why business lobbying appears to be “failing” here whilst it seems to succeed almost everywhere else. See *e.g.*, Thomas Stratmann, *Can Special Interests Buy Congressional Votes? Evidence from Financial Services Legislation*, 45 J. L. & ECON. 345, 357 – 66 (2002); Haddock & Macey, *supra* note 26; Daniel R. Fischel & Alan O. Sykes, *Corporate Crime*, 25 J. LEGAL STUDIES 319, 346 - 48 (1996). My answer is essentially that business lobbying is not exactly “failing”.

⁴⁷ There are many examples of this. See Roe, *supra* note 11, at 234 – 38 (noting that hostile takeovers and harsh bankruptcy policy increases the probability of severe political reaction); Mark Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 17 – 18 (1991) (discussing the Glass-Steagall Act as a

the Federal Securities Laws, the Foreign Corrupt Practices Act and other legislation surrounding Watergate, Insider Trading legislation in the mid-1980s, and the recent Sarbanes-Oxley Act.⁴⁸ Against this backdrop of increased calls for regulation, Congress must, as a political matter, act and the issue is what will it do.⁴⁹ Congress, however, has many options for regulating corporate behavior: it could enhance corporate civil liability, enhance corporate criminal liability, enhance liability for other parties (e.g., managers, accountants, and so forth), increase direct regulation generally, or rely on some combination of these options. Which option Congress chooses depends to some extent on the lobbying efforts of corporate interests – it is thus important to examine which of these options may be preferred by corporate interests.

For purposes of clarity, I examine two Congressional options although the analysis would be analogous for other options too. The first option is large increases in corporate civil liability. Congress could expand corporate civil liability by either increasing the kinds of things that are actionable or by increasing the penalties that corporations may suffer for engaging in certain behavior or both. For example, Congress could make acts X, Y and Z all new civil wrongs or Congress could increase the penalties attached to current wrongs or both. The second option is that Congress could expand corporate civil liability somewhat, but not to the extent of the large increases in the first option, and also criminalize the new wrongs. For example, Congress could make acts X and Y new civil wrongs and also make them new criminal wrongs if undertaken with the required *mens rea*. For ease of exposition, the first option is referred to as increases or enhancements in corporate civil liability and the second option is referred to as corporate crime legislation (i.e., moderate increases in corporate civil liability accompanied by criminalization of the underlying behavior).

response to the Great Depression); JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET 1 – 100* (1982) (providing a detailed account of the history and politics surrounding the Federal Securities Laws); JAMES D. COX, ROBERT W. HILLMAN, & DONALD C. LANGEVOORT, *SECURITIES REGULATION: CASES AND MATERIALS 1 – 31* (3rd ed., 2001) (discussing the securities laws); BRICKEY, *supra* note 16, at §1.02 at 5 – 6 (discussing legislation surrounding Watergate era); Raymond Paternoster & Sally Simpson, *Sanction Threats and Appeals to Morality: Testing a Rational Choice Model of Corporate Crime*, 30 *LAW & SOC'Y REV.* 549, 550 – 51 (1996) (discussing growth of legislation around Watergate era); Revesz, *supra* note 26, at 583 – 626 (discussing the environmental context).

⁴⁸ See Roe, *supra* note 11, at 234 – 38 (noting that hostile takeovers and harsh bankruptcy policy increases the probability of severe political reaction); Roe, *supra* note 47; COX ET AL., *supra* note 47; BRICKEY, *supra* note 16, at §1.02 at 5 – 6; Paternoster & Simpson, *supra* note 47; Revesz, *supra* note 26. Finally, the Enron-style scandals have led to the passage of Sarbanes-Oxley in 2002 in another economic downturn. See *infra* text accompanying notes 92 - 96.

⁴⁹ Congress may have to act in the sense that when these series of corporate scandals arise together the collective action problem faced by the general public and dispersed victims may be overcome. If Congress remains silent in the face of this activated group they are likely to face considerable difficulty at the next election and may also, in some countries, endanger longer run stability. See Roe, *supra* note 11; Larry Reynolds, *Washington Gets Tough on White-Collar Crime*, 79 *MANAGEMENT REVIEW* 27 (1990).

In this Part I examine why corporate interests may prefer corporate crime legislation over further enhancements in corporate civil liability given that some regulatory response is inevitable. In particular, I argue that some corporate interests prefer corporate crime legislation over enhancements in corporate civil liability primarily because corporate criminal liability (i) has been fairly low cost (ii) results in more targeted (and hence less frivolous) enforcement (iii) can have its enforcement more easily influenced by corporate interests, (iv) possesses stronger procedural safeguards (e.g., beyond reasonable doubt standard of proof), (v) tends not to have high supra-compensatory damages and (vi) less frequently imposes liability on third parties (e.g., accountants). I also discuss historical examples that tend to support this towards the end of this Part. Part IV then addresses why corporate interests may consider corporate crime legislation a preferred alternative to managerial liability and sanctions.

A. *Low Cost Corporate Crime Legislation – Of Symbolic Measures.*

One of the first things to note about corporate crime legislation is that enforcement has traditionally been quite thin – indeed it may appear largely symbolic.⁵⁰ The evidence suggests that the number of prosecutions per year is quite small, has remained nearly constant for the last decade, and that most prosecutions occur against smaller firms.⁵¹ This suggests that corporate crime legislation may not generally be perceived as a big threat to management and big business.⁵²

⁵⁰ See UNITED STATES SENTENCING COMMISSION ANNUAL REPORT 2001, available at <http://www.ussc.gov/ANNRPT/2001> (last visited Mar. 21, 2003); Harry First, *Criminal Antitrust Enforcement*, Occasional Papers from the Center for Research in Crime and Justice, NYU School of Law, 1991 (noting that many antitrust enforcement actions have been against smaller firms); Cindy Alexander, Jennifer Arlen & Marc Cohen, *Regulating Corporate Criminal Sanctions: Federal Guidelines and the Sentencing of Public Firms*, 42 J. L. & ECON. 393, 403 (1999); Jeffrey S. Parker, *Rules without...: Some Critical Reflections on the Federal Corporate Sentencing Guidelines*, 71 WASH. L. U. Q. 397, 399 – 400 (1993).

⁵¹ See UNITED STATES SENTENCING COMMISSION ANNUAL REPORT 2001, available at <http://www.ussc.gov/ANNRPT/2001> (last visited Mar. 21, 2003); Alexander, et al., *supra* note 50, at 403; First, *supra* note 50; Joe Davidson, *Corporate Sentencing Guidelines Have Snagged Mostly Small Firms*, 28 August 1995, THE WALL STREET JOURNAL, at B3 (stating that “[t]he commission said 97% of the 280 firms sentenced under the guidelines since they took effect have been privately held or controlled by only a small group of shareholders”); Annie Geraghty, *Corporate Criminal Liability*, 39 AM. J. CRIM. L. REV. 327, 338 (2002) (noting that the majority of defendants sentenced are small, closely held organizations); Judge Diana E. Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 1291 PLI/CORP 97, 113 (2002) (finding median number of employees at convicted corporations to be 20); Jed S. Rakoff, *Avoiding Corporate Indictments Under New Sentencing Guidelines*, BUS. CRIMES BULL: COMPLIANCE & LITIG., Feb. 1994, at 2 (stating that Commission data suggests that prosecutors are reluctant to indict public companies unless there are very serious offenses by high-level managers). One might view the fact that most convictions arise against small firms as indicative that corporate crime legislation benefits incumbent firms and harms smaller firms and that perhaps incumbents push for such legislation. *Cf.* Paul G. Mahoney, *The Political Economy of the Securities Act of 1933*, 30 J. LEGAL STUD. 1 (2001) (arguing that the Securities Act of 1933 reduced competition in certain markets). I suspect this is often a good explanation for regulation generally, but for reasons noted in Part VI.A. I doubt this provides a strong explanation for corporate crime legislation.

⁵² See Nancy K. Frank & Michael J. Lynch, *Corporate Crime Corporate Violence: A Primer* 126 (1992) (criminal sanctions viewed by corporations as a “cost of doing business”).

This can be contrasted to corporate civil liability, which is enforced by both government agencies and private litigants. The enforcement here is much greater (especially by private litigants) and is likely to generate more costs for corporations than the limited amount of criminal enforcement.⁵³ For corporations the likelihood of enforcement is an important factor because they face essentially monetary sanctions in both civil and criminal proceedings.⁵⁴

Moreover, the penalties in the civil side are usually *greater* than those in the criminal side.⁵⁵ There is considerable evidence that corporate crime penalties are perceived to be generally lower than corporate civil sanctions.⁵⁶ Thus, if corporations had the option of choosing between corporate crime legislation and enhancements in corporate civil liability they might prefer corporate crime legislation because its enforcement is less frequent and often its penalties are lower than those in corporate civil liability. Simply put, corporate criminal liability may have lower expected costs than increases in corporate civil liability.

One caveat is in order. Over the last decade or so the criminal penalties imposed on corporations have increased,⁵⁷ as have corporate expenditures on

⁵³ See generally Brent Fisse, *Reconstructing Corporate Criminal Law: Deterrence, Retribution, Fault, and Sanctions*, 56 S. CAL. L. REV. 1233-37 (1983). See also *Corporate and White Collar Crime: An Anthology* 15-16 (Leonard Orland, 1995). See also Frank & Lynch, *supra* note 52, at 123.

⁵⁴ See Kip Schlegel, *Just Deserts for Corporate Criminals* 22 – 30 (1990). See also Alexander, *supra* note 50, at 395; Orland, *supra* note 53, at 25-26. See also *Corporate Misconduct: The Legal, Societal, and Management Issues* 60-66 (Margaret P. Spencer & Ronald R. Sims eds., 1995)(calculation of fines).

⁵⁵ See Alexander, *supra* note 50, at 395. See also Schlegel, *supra* note 54, at 11.

⁵⁶ See, e.g., Philip Shenon, *Ideas & Trends: Proposals for Punishment; The Case of the Criminal Corporation*, N. Y. TIMES, Jan. 15, 1989, at 28; William Glaberson, *S.E.C. Aide Assails Plan on Punishing Companies*, N. Y. TIMES, Oct. 12, 1988, at D3, p. 6; Stephen Labaton, *Corporate Penalty Plan Stirs Debate*, N. Y. TIMES, Oct. 10, 1988, at D3, p. 1. There are, of course, reputational sanctions imposed on corporations from both corporate civil liability and corporate criminal liability that are relevant in assessing the costs of each kind of liability. Most studies of reputational effects on corporations (measured by drops in share price associated with revelations of wrongdoing) find that they are (i) sometimes quite large (ii) about the same regardless of the type of proceedings (civil or criminal) holding the kind of wrongdoing and official sanction size constant and (iii) that reputational penalties tend to be positively correlated with the size of the official sanction (suggesting that larger official sanctions under corporate civil liability may generate greater reputational losses). See Jonathan M. Karpoff & John R. Lott, Jr., *The Reputational Penalty Firms Bear for Committing Criminal Fraud*, 36 J.L. & ECON. 757, 758 (1993) (noting that “[r]eputational cost... constitutes most of the cost incurred by firms accused or convicted of fraud.”); Jonathan M. Karpoff & John R. Lott, *On the Determinants and Importance of Punitive Damage Awards*, 42 J.L. & ECON. 527, 570 (1999) (arguing that “firm values and the use of reputational investments to assure contractual performance, however, will be affected by both the size and predictability of prospective punitive awards.”); Cindy R. Alexander, *On the Nature of the Reputational Penalty for Corporate Crime: Evidence*, 42 J.L. & ECON. 489, 491 (1999). This suggests that the presence of reputational losses is important, but that corporate civil liability may tend to have greater or similar reputational losses to corporate criminal liability.

⁵⁷ Following the Organizational Sentencing Guidelines, the penalties imposed on convicted corporations have increased, perhaps by up to 5 to 10 times their pre-Guideline levels. See Alexander, et al., *supra* note 50, at 409 – 413. Indeed, penalties in Health Care, Environmental, Securities and Antitrust fields have all increased over the last decade by quite a lot. See Mary B. Neumayr, *An Examination of the Criminalization of Commercial Activity*, (Draft Paper 2002, on file with author), available at: <http://www.fed->

compliance.⁵⁸ The increased compliance expenditures suggest that the perceived costs of corporate or executive criminal liability have grown enough to justify these expenditures, implying that these costs are not so trivial.⁵⁹ This may be

soc.org/pdf/CrimFinal.pdf. The recent increases under Sarbanes-Oxley ratchet up penalties even further. See USSC Report, *supra* note 6.

It is still possible that expected penalties might be small if detection rates are small. However, detection rates for corporate wrongdoing tend to vary quite a bit with the type of wrongdoing. See Neumayr, *supra*, at 8 – 11 (discussing Qui Tam enforcement which is sometimes considered frivolous). Cf. Jeffrey S. Parker, *Criminal Sentencing Policy for Organizations*, in U.S. SENTENCING COMMISSION, DISCUSSION MATERIALS ON ORGANIZATIONAL SANCTIONS (1988), reprinted in 10 WHITTIER L. REV. 1, 55 (1988) (stating that the likelihood of detection and conviction for antitrust is estimated by the DoJ as being about 10%). But see Marc D. Goodman, *Why the Police Don't Care About Computer Crime*, 10 HARV. J. L. & TECH. 465, 475 (1997) (noting that for some computer crime rates of escape may be about 98%).

⁵⁸ See generally SENTENCING GUIDELINES, *supra* note 6, at §8C2.5(f); William S. Laufer, *Corporate Prosecution, Cooperation, and the Trading of Favors*, 87 IOWA L. REV. 643 (2002); Murphy, *supra* note 51, at 111, 115, 116; Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559 (1990).

One of the primary corporate responses to the organizational sentencing guidelines has been to invest increased resources and effort in promulgating compliance programs that could earn the corporation a sanction reduction under the guidelines. Under the guidelines a “reasonably effective” compliance program could lead to substantial reductions in corporate penalties. See *How the Organizational Guidelines Work: An Overview*, <http://www.ussc.gov/SYMPO/WCSYMPO1.HTM>. These compliance programs are, however, generally considered expensive to devise and implement and would only be worth the expense if they generated a benefit (e.g., reduced penalties and reduced wrongdoing) that was worth the cost. See also Alan Kline, *Cost of Compliance*, AMERICAN BANKER, April 19, 2002, <http://www.americanbanker.com> (quoting Bob Wilmers, Chairman, M&T Bank Corp. “The cost of regulatory compliance is not insubstantial...[w]e estimate that our annual cost ...is now up to \$37 Million and counting”); ERNST & YOUNG, CORPORATE COMPLIANCE PROGRAMS: LEADING PRACTICES SURVEY (2001); Robert J. Ambrogi, *Browse Your Way to Compliance*, Law.com, 01-27-03, <http://www.law.com/servlet/ContentServer?pagename=OpenMarket/Xcelerate/View&c=LawArticle&cid=1042568695687&live=true&cst=1&pc=0&pa=0> (noting that “Times are good for businesses that provide corporate compliance training online. Los Angeles’ Legal Knowledge Co., for example, saw contracts for its Web-based Legal Compliance and Ethics Center (LCEC) double in the past year, to \$100 million.” – this is just one corporation that provides only training services).

⁵⁹ I do not rely on claims by corporations that they are “truly” scared of corporate criminal liability because such claims may reflect one of at least 3 things. First, that corporation criminal liability does impose significant costs. Second, corporate criminal liability does not impose large costs, but corporations have self-serving reasons to claim that it does (e.g., to prevent more harmful measures). Third, that managers are scared by corporate criminal liability because the initiation of a prosecution against the corporation might be viewed as a signal that criminal prosecutions against managers are likely. See Laufer, *supra* note 58, at 649 – 52 (noting that cooperation and presumably compliance programs would reduce the likelihood of the corporation being charged which may help evade liability for higher ups).

There is a question of how compliance programs became so important in the corporate wrongdoing area – who lobbied for them. It appears that both corporate interests and law firms lobbied for them. See Fischel & Sykes, *supra* note 46, at 348 (noting that compliance programs are a bonanza for law firms because of the business it generates for them); Jonathan R. Macey, *Agency Theory and the Criminal Liability of Organizations*, 71 B.U.L.REV. 315, 316 (1991); Reynolds, *supra* note 49. Why might this be? Corporations and management might be scared of government investigations revealing personal (i.e., managerial) wrongdoing and the presence of a reasonable compliance program may lead prosecutors not to investigate further and uncover these wrongs or incriminating evidence. See Laufer, *supra* note 58, at 657 – 60. Also, law firms may not be providing management with the best advice about the true risks of liability given that they sell (and hence benefit financially) from the provision of compliance services. See Fischel & Sykes, *supra* note 46, at 348. Cf. John C. Coates IV, *Explaining Variation in Takeover Defenses: Failure in the Corporate Law Market*, 89 CAL. L. REV. 1301 *passim* (2001) (discussing how variation in takeover defenses at the IPO stage may be explained by the corporations using different law firms).

increasingly true, but that does not change my analysis in this section. My analysis simply requires that corporate civil liability be more costly to corporations than corporate criminal liability. There is evidence that not only have the costs of corporate criminal liability increased recently, but so have the costs of corporate civil liability (and by at least as much).⁶⁰ We would thus still expect that corporations would prefer corporate crime legislation over increases in corporate civil liability.⁶¹

B. Targeted Enforcement

Enforcement of corporate criminal and civil liability occurs in somewhat different ways. Corporate civil liability is enforced by both government agencies

⁶⁰ See Khanna, *supra* note 8, at 1514 (noting that “[t]he recent increases in the severity of corporate sanctions in both the civil and criminal spheres may indicate a belief that sanctions are still not stiff enough to deter undesirable behavior.”). The analysis thus far does not indicate how or why corporate penalties increased as much as they did in the guidelines. An explanation for this change cannot be explored in the limited space of this article, but there were suggestions that the pre-guidelines sanctions were considered quite low. See Alexander, et al., *supra* note 50, at 395. Also, it is possible that had these increases not gone through even more costly measures could have been undertaken. After all, the guidelines came about on the heels of the Watergate scandal, insider trading cases and the savings and loan debacle. This presumably was associated with a large amount of public outcry with corporate wrongdoing. When this is combined with the greater impact corporations have on our everyday lives than in the past one can imagine how liability increases might become more common now than in the past. See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1481 – 84.

⁶¹ See discussion *supra* note 59. Another noteworthy point is that compliance expenditures are not only useful in reducing criminal sanctions, they may reduce civil sanctions too. Compliance programs may reduce the total *civil* sanction suffered by a corporation in two ways. First, sometimes the presence of such programs could lead to a finding of no (or lesser) liability. See *Burlington Industries v. Ellerth*, 118 S.Ct. 2257 (1998); *Faragher v. City of Boca Raton*, 118 S.Ct. 2275 (1998); Michael Harper, *Employer Liability for Harassment Under Title VII: A Functional Rationale for Faragher and Ellerth*, 36 SAN DIEGO L. REV. 41 (1999); Allan Horwich, *Section 11 of the Securities Act: The Cornerstone Needs Some Tuckpointing*, 58 BUS. LAW. 1 (2002). Second, if these programs have a deterrent effect then the number of wrongs would decrease and so would the number of civil suits premised on these wrongs. Thus, both the magnitude and frequency of civil sanctions could decrease. This provides yet another benefit to compliance programs (along with reductions in the magnitude and frequency of criminal penalties) that should be weighed against its costs and also suggests that it is not simply increases in criminal sanctions triggering compliance expenditures. Indeed, it might be that the reductions in civil liability motivate the increased expenditure on compliance programs. For example, it may be that compliance programs cost \$200 Million, but reduce criminal penalties by \$20 Million and civil sanctions by \$181 Million. Nonetheless, the timing of the growth in compliance expenditures seems to coincide with the organizational sentencing guidelines (i.e., criminal sanctions) suggesting that they may well be the critical trigger. Cf. Laufer, *supra* note 58, at 650 – 54 (noting that the issue of corporate compliance got a huge lift following the organizational sentencing guidelines); Murphy, *supra* note 51, at 111, 115, 116 (noting large impact of organizational sentencing guidelines on compliance activity). One explanation for this might be that the criminal penalties were the amount needed at the margin to trigger the growth of compliance programs although this would assume a fairly accurate sanction setting policy by the government, which may not necessarily be the case.

Another interpretation is that compliance programs reduce the likelihood of investigation and prosecution of corporations which implicitly reduces likelihood of managers being investigated and prosecuted. See Laufer, *supra* note 58, at 649 – 52 (noting that cooperation and presumably compliance programs would reduce the likelihood of the corporation being charged which may help evade liability for higher ups).

(e.g., the SEC) as well as private litigants,⁶² whereas corporate criminal liability is enforced by the Department of Justice (DoJ) *only*.⁶³ The different sets of enforcers are important to corporate interests.

It would appear safe to assume that private litigants are more likely than government agents to bring frivolous suits.⁶⁴ The core reasons are quite straightforward. First, private litigants may receive direct financial gains by pursuing frivolous or questionable suits against corporations, whereas government agents generally do not receive direct financial gains from these suits.⁶⁵ Second, government agents are working within some kind of enforcement budget that may operate to reduce the likelihood of too many frivolous suits.⁶⁶ If prosecutors have a budget constraint and they want to maximize convictions then they tend to use their resources for cases they believe are more likely to result in convictions.⁶⁷ Presumably, this pushes them away from the weak and frivolous cases and toward the more meritorious cases, which as a general matter should be easier cases in which to obtain convictions.⁶⁸

⁶² See Frank & Lynch, *supra* note 52, at 26 – 27.

⁶³ I am referring to Federal Corporate Crime Legislation. State corporate crime laws are enforced by state prosecutors. See Spencer & Sims, *supra* note 54, at 36 – 38.

⁶⁴ This is not to suggest that prosecutors always bring socially desirable suits, but only that they tend to bring socially undesirable suits less frequently than private litigants. See Toobin, *supra* note 40, at 9. For these concerns in the context of recent securities regulation see Selective Disclosure and Insider Trading, Exchange Act Release No. 34-43154, 2000 WL 1201556 (Aug. 15, 2000) and Stephen Choi, *Selective Disclosure in the Public Capital Markets*, 35 U.C. DAVIS L.REV. 533, 540 – 69 (2002) (discussing the efficiency consequences of Reg. F-D). For discussions on how prosecutors incentives may diverge from the socially optimal see Edward L. Glaeser, Daniel P. Kessler, & Anne M. Piehl, *What Do Prosecutors Maximize? An Analysis of the Federalization of Drug Crimes*, 2 AM. L. & ECON. REV. 259, 261 (2000) (noting that decisions to prosecute are often influenced by prosecutors' interest in running for higher office); Stuntz, *supra* note 44, at 533 (noting that "local prosecutors are likely to seek to produce the range of outcomes the public desires"); Peter Krug, *Prosecutorial Discretion and Its Limits*, 50 AM. J. COMP. LAW 643, 662 (2002) (noting that police misconduct prosecution occurs only in cases of high public visibility).

⁶⁵ See Mark A. Cohen & Paul H. Rubin, *Private Enforcement of Public Policy*, 3 YALE J. ON REG. 167, 169 (1985) (noting that "[t]hird, and most important, private enforcement agents, unlike government regulators, will possess ongoing economic interests directly related to the costs and benefits of public policy implementation." (also acknowledges generally that government agencies do not have as much incentives as private litigants)). See generally Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance, and the Compensation of Enforcers*, 3 J. LEGAL STUD. 1, 13 (1974) (suggesting that compensation scheme for public enforcers should emulate scheme of private enforcers, given that there is much greater private incentive to enforce).

⁶⁶ See J. Mark Ramseyer & Eric B. Rasmusen, *Why Is the Japanese Conviction Rate So High?*, 30 J. LEGAL STUD. 53, 71 – 72 (2001); Edward D. Cavanagh, *Detrebling Antitrust Damages: An Idea Whose Time Has Come?*, 61 TUL. L. REV. 777, 807 (1987) (noting that "[o]n the contrary, given the limited resources available to public enforcement agencies, the government presumably is better able to take into account relevant enforcement costs and prosecute only those matters which are truly in the public interest.")

⁶⁷ See Ramseyer & Rasmusen, *supra* note 66, at 71 – 72. I do not mean to suggest that maximizing convictions is the only thing prosecutors care about. There may be many other things that matter to prosecutors too, but convictions are important. For discussion of some other factors that may influence prosecutors see Glaeser, et al, *supra* note 64, at 261; Krug, *supra* note 64, at 662. See also *infra text accompanying notes 162 & 173*.

⁶⁸ See *id.* Of course, it is plausible that easier convictions may not be the socially most valuable ones to pursue.

However, in the private litigation setting with class actions, contingency fees and entrepreneurial attorneys things are likely to be different.⁶⁹ This is not to say that government agents cannot benefit from frivolous suits, but that as a general matter they are less likely to initiate frivolous litigation compared to private litigants.⁷⁰ In light of this, corporate interests might be more inclined to prefer less frivolous (read costly) litigation via corporate crime legislation than more frivolous litigation via increases in corporate civil liability. This would lead to corporate interests preferring corporate crime legislation over enhancements in corporate civil liability. Indeed, there is considerable evidence from the antitrust and securities laws fields that business interests often prefer government enforcement to private litigation.⁷¹

C. *Influencing the Enforcers*

Another sense in which the identity of the enforcer is important is that government enforcers operate within a budget *that is subject to Congressional control*.⁷² In light of this, corporate interests can influence the enforcement of criminal laws – by lobbying over enforcement budgets – in a manner they cannot for civil liability when enforced by private litigants.⁷³ For example, corporate interests could lobby for a lower enforcement budget and thereby reduce the frequency of enforcement.⁷⁴ Furthermore, there is a rich literature discussing

⁶⁹ See Cavanagh, *supra* note 66, at 807; Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 536 (1997) (noting that “[t]he costs of defense impose pressure on defendants to settle even weak cases, pressure that was aggravated by the financial incentives created by the third party payment structure of insurance and indemnification.”). See also Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG’N. 55, 57 (1991).

⁷⁰ See Cohen & Rubin, *supra* note 65, at 169; A. C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 959 – 62; 1017 – 18 (2001) (discussing incentives of private litigants and the SEC); Richard W. Painter, *Game Theoretic and Contractarian Paradigms in the Uneasy Relationship Between Regulators and Regulatory Lawyers*, 65 FORDHAM L. REV. 149, 169 (1996) (emphasizing that enforcement officials have job-advancement incentives to thoroughly enforce infractions, but not mentioning monetary gain for SEC).

⁷¹ See *Antitrust Advance*, N.Y. TIMES, Jun 17, 1976, at 34; Susan Antilla, *A Battle Over Securities-Fraud Cases*, N.Y. TIMES, Jul. 4, 1993, at 313; Jeff Gerth, *Overhaul of Securities Laws: A Fast Track to Change or a Hasty Decision?*, N.Y. TIMES, May 26, 1995, at A19; Bruce Rubenstein, *Cease and Desist*, CORP. LEGAL TIMES, Sept. 1994, at 1; Neil A. Lewis, *House Passes Bill That Would Limit Suits of Investors*, N.Y. TIMES, Mar. 9, 1995, at A1.

⁷² See William J. Carney, *Signaling and Causation in Insider Trading*, 36 CATH. U.L. REV. 863, 897 (1987) (noting that individuals can lobby Congress to sustain the SEC’s enforcement budget); Ronald E. Bornstein & Elaine Dugger, *The Global Securities Market: International Regulation of Insider Trading*, COLUM. BUS. L. REV. 375, 378 (noting that “[t]he Senate Banking Committee also has held several hearings regarding the problem of insider trading in the context of corporate mergers and takeovers. In the course of those hearings, recommendations were made to clarify the offense of insider trading and to increase the portion of the SEC’s budget allocated to related enforcement activities”).

⁷³ See Richman, *Delegation*, *supra* note 40; Christopher Drew, *In the Productivity Push, How Much Is Too Much?*, N.Y. TIMES, Dec. 17, 1995, at C1. Cf. William N. Eskridge, Jr., *Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 75 VA. L. REV. 275, 289 (1988) (indicating that when legislators give power to regulatory agencies, those agencies become the focus of competing interests).

⁷⁴ See Richman, *Delegation*, *supra* note 40, at 776 – 79; Cynthia Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265, n. 380 (1998) (indicating that U.P.S. lobbied to decrease the

how corporate interests may be able to “capture” agencies and their enforcement.⁷⁵ Finally, lobbying over enforcement budgets is somewhat less visible than direct lobbying over legislation. Thus, corporate interests would prefer government enforcement of the law as that still leaves them with more influence in the enforcement process.

This, however, only tells us part of the story because government enforcement can be achieved through civil (SEC, EPA) or criminal proceedings (DoJ). Simply put, corporations could lobby to have exclusively government civil enforcement (i.e., prohibit private litigation) rather than corporate crime legislation. This is possible, but as a political matter it is unlikely that the government could generally exclude private enforcement of harmful wrongs.⁷⁶ The tradition in the US is to extend some private rights of action (even implicitly) when there is an expansion of corporate liability.⁷⁷ Moreover, the desire for compensation and a distrust of government together combine to make excluding private enforcement a fairly infrequent event.⁷⁸ In light of this let us compare increases in corporate civil liability to corporate crime legislation. An increase in corporate civil liability involves, say, the creation of three new civil wrongs (and hence more private suits). Corporate crime legislation usually involves the creation of some civil wrongs (say two new ones) and then criminalizing these new wrongs.⁷⁹ For corporate interests corporate crime legislation involves fewer new wrongs, than increases in corporate civil liability, and hence less scope for private suits. Thus, corporate interests may view corporate crime legislation as

OSHA’s budget and that corporations direct some efforts to “lobby to reduce penalties for violations and to reduce funds for enforcement of existing law”).

⁷⁵ See S.M. PHILLIPS & J.R. ZECHER, *THE SEC AND THE PUBLIC INTEREST* 21 – 24 (1981); Jonathan Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 *CARDOZO L. REV.* 909 (1994).

⁷⁶ See Adam F. Ingber, Note, *10b-5 or not 10b-5? Are the Current Efforts to Reform Securities Litigation Misguided?*, 61 *FORDHAM L. REV.* 351, 353-55 (SUPP. 1993) (stating that private enforcement of the 1934 Securities laws is “essential for efficient markets”); Pritchard, *supra* note 70, at 1017 n. 397; Jeffrey P. Strickler, Comment, *Inside Information and Outside Traders: Corporate Recovery of the Outsider’s Unfair Gain*, 73 *CALIF. L. REV.* 483, 508-09 (1985) (advocating use of private enforcement in securities law often because “government enforcement agencies are overburdened and cannot adequately police the market.”); Joel Seligman, *The SEC’s Unfinished Soft Information Revolution*, 63 *FORDHAM L. REV.* 1953, 1988 (1995) (noting that “[g]iven the limited Commission [SEC]resources available for the enforcement of its mandatory disclosure system, private litigation has been recognized as performing a useful augmentative deterrent, as well as compensatory, role”).

⁷⁷ See, e.g., Virginia G. Maurer, *Antitrust and RICO: Standing on the Slippery Slope*, 25 *GA. L. REV.* 711 (1991) (noting that “[s]ince 1890, federal statutes have provided a private civil damages action to augment public enforcement of antitrust laws.”).

⁷⁸ See Donald C. Langevoort, *Capping Damages for Open-Market Securities Frauds*, 38 *ARIZ. L. REV.* 639, 652 (1996) (noting that “the conventional view that private litigation is a necessary supplement to SEC enforcement is well-grounded.”). However, recent measures in securities regulation arena, such as Regulation F-D, appear to rely more exclusively on government enforcement. See COX, *supra* note 47, at 976 – 82.

⁷⁹ Criminalizing civil wrongs does not create new grounds of recovery for private litigants.

preferable because it creates fewer grounds for private litigant recovery than increases in corporate civil liability.⁸⁰

D. Procedural Protections

As a general matter corporate criminal liability requires the moving party to meet more procedural hurdles than corporate civil liability. For example, in criminal proceedings the moving party must prove the offense beyond a reasonable doubt and has to deal with many other procedural rules that apply only, or largely, in criminal cases (e.g., double jeopardy, right to a jury trial).⁸¹ In civil cases the moving party (even the government) must only prove liability on the preponderance of the evidence and is subject to lesser procedural restrictions than in the criminal process.⁸² To the extent that these criminal procedures impede convictions, corporate interests prefer criminal liability over corporate civil liability for which judgments are easier to obtain.⁸³

E. Supra-Compensatory Damages

Corporate civil liability when enforced by private litigants involves the real risk of supra-compensatory damages. There are many areas of law where treble damages or punitive damages may be available to private litigants.⁸⁴ The areas where the government can claim such large sanctions are more limited.⁸⁵

⁸⁰ One might view Sarbanes-Oxley 2002 as an example of this. Note also that the analysis in the text suggests that private interests (litigants and their attorneys) favor increases in corporate civil liability over corporate crime legislation. Thus, private interest support for corporate crime legislation would, one expects, be weaker than for increases in corporate civil liability. See *infra text accompanying note 211*.

⁸¹ See generally *Development*, *supra* note 16. See also Alexander Kovel, *A Case for Civil Penalties: Air Pollution Control*, 46 JOURNAL OF URBAN LAW 153, 159 (1969); Frank & Lynch, *supra* note 52, at 26 – 28 (difficulty of proving intent, standard of proof, and procedural rights).

⁸² On the higher standard of proof see Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1512 – 17. On corporate procedural protections see V.S. Khanna, *An Analysis of Procedural Protections for Corporate Defendants*, Draft Paper 2003 (on file with author). On the importance of budgetary allocation for prosecution. See Richman, *supra* note 40, at 789 – 810. There is evidence that in some spheres enforcement budgets have increased somewhat. See Neumayr, *supra* note 57, at 8 – 9 (discussing environmental enforcement). Indeed, one might argue that spikes in the SEC's budget may serve to head off increases in civil liability too.

⁸³ The importance of these procedural safeguards is diminished when there is a great deal of criminalization because the increasing amount of potential criminal liability makes it easier for prosecutors to obtain convictions in spite of the procedural safeguards. See Stuntz, *supra* note 44, at 537 – 38. This is due to the greater breadth of the law and greater threat value of trials when criminalization is rampant. See *id.*

⁸⁴ See Orland, *supra* note 54, at 16. See also 18 U.S.C. §§ 1961-1968 (1982) (treble damages available under the Racketeer Influenced and Corrupt Organizations Act (RICO)); Charles A. Sullivan, *Breaking Up the Treble Play: Attacks on the Private Treble Damage Antitrust Action*, 14 SETON HALL L. REV. 17, 18-25 (development of treble damages in antitrust actions).

⁸⁵ For further anecdotal support consider the infamous Exxon Valdez case. In that case one suspects that many more people were aware of the civil punitive damages award than the criminal penalties. Although Exxon received a \$150 million fine as per a criminal plea agreement, the court forgave \$125 million of it in recognition of Exxon's cooperation in cleaning up the spill and paying certain private claims. See Consent Decree and Agreement at 18-19, Clerk's Docket No. 46 in *United States v. Exxon Corp.*, No. A91-

Consequently, corporate interests may prefer governmental enforcement because it is likely to lead to lesser sanctions than private litigant enforcement. The preferred form of government enforcement may well be criminal because that reduces the scope for private litigant recovery as argued in section C.

F. Third Party Liability

In civil proceedings the corporation is not the only party who may be pursued. For example, in a standard securities law civil suit the defendants could be the corporation, its officers and directors, its accountants, its attorneys, and its underwriters.⁸⁶ In criminal cases – although we can pursue third parties – it is more difficult to impose liability on them (often due in part to *mens rea* requirements).⁸⁷ This may be valuable to corporations because they often bear a large chunk of the costs associated with third party liability.⁸⁸ For example, if third parties contract with the corporation in some form (e.g., to provide accountancy services) then the increased risk of bearing sanctions for third parties would probably be reflected in higher prices (e.g., higher accounting fees) to the corporation.⁸⁹ If the expected cost to third parties is less under criminal regimes (because of more frequent *mens rea* requirements, higher proof standards, and so on) than under civil liability then we might expect corporate interests to prefer the lower cost criminal alternative. After all, the corporate interests bear a

0082-CV, and Clerk's Docket No. 26 in *Alaska v. Exxon Corp.*, No. A91-0083-CV. In contrast, as part of its civil settlement, Exxon agreed to pay \$900 million in addition to the \$2.1 billion they had already spent on the clean-up. *Id.* The settlement also contains a "reopener window" between September 1, 2002 and September 1, 2006, during which the governments may make a claim for up to an additional \$100 million. *Id.* In addition, Exxon remained subject to civil suits by private parties which resulted in a \$5 billion punitive jury award (the largest punitive judgment ever suffered by a U.S. corporation). See *Spillionaires*, ANCHORAGE DAILY NEWS, March 17, 1996, at B3, available at <http://www.adn.com/evos/stories/EV402.html> (last visited March 16, 2003). Also, even after the guidelines the criminal fine is still only a small portion of the total loss the corporation suffers from wrongdoing. See Alexander, et al., *supra* note 50, at 409 – 10; Karpoff & Lott, *supra* note 56, at 758 (noting that "[r]eputational cost... constitutes most of the cost incurred by firms accused or convicted of fraud.").

⁸⁶ See e.g., Spencer & Sims, *supra* note 54, at 89 – 91 (liability for accountants); George D. Reycraft, *Symposium: The Role of Counsel in Corporate Acquisitions and Takeovers: Conflicts and Complications: Conflicts of Interest and Effective Representation: The Dilemma of Corporate Counsel*, 39 HASTINGS L.J. 605, 607 (noting that "[a] fourth factor that cannot be overlooked is that the lawyer or law firm usually maintains a sizable malpractice insurance policy. Thus lawyers, like accountants and underwriters, are often seen as "deep pockets" and a ready source of settlement or award money.").

⁸⁷ *Cf. Developments*, *supra* note 16, at 1259 – 75. *But see* Neumayr, *supra* note 57, at 11 (arguing that negligence standards are increasing).

⁸⁸ See Reinier H. Kraakman, *Gatekeepers The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG'N. 53, 73 (1986).

⁸⁹ See A. Mitchell Polinsky & Steven Shavell, *Should Employees be Subject to Fines and Imprisonment Given the Existence of Corporate Liability?* 13 INT'L. REV. L. & ECON. 239, 241 (1993) (noting that "[w]hen employees face the risk of fines, they naturally will demand higher compensation from firms, everything else being equal. In effect, this will cause firms to pay fines in the form of higher wages"); Richard W. Painter, *Toward a Market for Lawyer Disclosure Services: In Search Optimal Whistleblowing Rules*, 63 GEO. WASH. L. REV. 221, 239 (1999) (noting that an increase in liability for attorneys for failure to disclose their clients' illegal practices will result in risk premiums charged by whistleblowers).

large portion of these costs through the prices they must pay third parties to contract with them.

G. *Substitution Thesis Examples*

For the reasons identified above we might expect corporate interests to prefer corporate crime legislation over enhancements in corporate civil liability when some Congressional response is inevitable. If so, do we see instances of this? I would argue that there is evidence which, although not conclusive, is supportive of the substitution thesis.⁹⁰

Let us begin with the most recent series of corporate scandals involving accounting misrepresentations and securities fraud. One response could have been to repeal the Private Securities Litigation Reform Act 1995 (PSLRA) and overturn some related US Supreme Court jurisprudence.⁹¹ This is because the PSLRA restricted the scope of private securities fraud liability and, along with some US Supreme Court precedent, made it harder to impose liability on associated parties (e.g., accountants).⁹² This in turn insulated accountants and issuers, to some extent, from securities fraud liability thereby reducing the costs associated with securities fraud (for them) and, arguably, increasing the incentive to engage in it.⁹³ Repealing the PSLRA and overturning associated US Supreme Court precedent might combat this and would operate as an increase in corporate civil liability because it opens up the corporation and accountants to greater liability.

Indeed, post-Enron people did attempt to lobby essentially for this.⁹⁴ Some groups lobbied Congress to repeal provisions of the PSLRA and to open up third parties to greater liability.⁹⁵ However, these initiatives were ultimately unsuccessful and instead Sarbanes-Oxley was enacted which, amongst other

⁹⁰ An explanatory note is perhaps in order. I do not expect that there will be direct documentary evidence indicating that corporate interests ignored or supported corporate crime legislation in order to avoid increases in corporate civil liability. Such “smoking gun” memos would be truly useful, but given the likely sophistication of most corporate interests unlikely to find. Rather, I provide examples of where, when some kind of Congressional response was inevitable, corporate interests appeared to lobby most strongly against increases in corporate civil liability and said little if anything against increases in corporate crime legislation. Although this evidence is not as compelling as a “smoking gun” memo, the pattern created over time does provide some indication as to the lobbying activities of corporate interests.

⁹¹ See Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in various sections of 15 U.S.C.); *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994).

⁹² See John C. Coffee, Jr., *Understanding Enron: 'It's About the Gatekeepers, Stupid'*, 57 BUS. LAW. 1403, 1409 – 12 (2002).

⁹³ See Coffee, *supra* note 92. There are other explanations for the recent spate of fraud. See *id.*, at 1412 – 13 (discussing an “irrational market”), 1413 – 16 (discussing other explanatory matters).

⁹⁴ See discussion with Professor John Coffee, Feb. 28, 2003; Adam C. Pritchard, *Should Congress Repeal Securities Class Action Reform?*, 471 POLICY ANALYSIS 12 – 14 (Feb. 27, 2003).

⁹⁵ See Coffee, *supra* note 94; Pritchard, *supra* note 94.

things, ratchets up criminal penalties.⁹⁶ Moreover, we saw little corporate opposition to Sarbanes-Oxley compared to the opposition to moves to enhance corporate civil liability via repeal of the PSLRA.⁹⁷

This pattern, however, is not unique to Sarbanes-Oxley. If we examine lobbying around the Foreign Corrupt Practices Act we also notice that criminal liability generates little concern.⁹⁸ Indeed, it appears that there was more corporate opposition to proposals to require disclosure of payments made to foreign government officials.⁹⁹ These disclosure requirements would have imposed a large burden on both corporations (to comply with the requirement) and on the government (to enforce the requirement).¹⁰⁰ In the end the disclosure requirements did not come to pass and instead we see an increase in criminal liability.¹⁰¹ By all accounts the costs of this criminal liability for business interests are quite small.¹⁰² One might interpret these events as suggesting that corporate interests preferred criminalization because it was lower cost than disclosure requirements.

Corporate interests have also been known to oppose increased enforcement by private litigants while being less opposed to increased government enforcement. This is consistent with the notion, discussed earlier, that corporate interests may prefer government enforcement because it is more targeted and more subject to their control. For example, in the 1970s there were

⁹⁶ See generally Public Accounting Reform and Investor Protection Act of 2002, Pub.L. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C.A and 18 U.S.C.A.). See UNITED STATES SENTENCING COMMISSION REPORT TO THE CONGRESS: INCREASED PENALTIES UNDER THE SARBANES-OXLEY ACT OF 2002, (Jan. 2003), http://www.ussc.gov/r_congress/S-Oreport.pdf. The new law essentially creates fewer private claims than might repeal of the PSLRA.

Besides corporate crime legislation there are other areas where corporations may rely on some kind of substitution thesis. For example, it has been argued that Delaware Corporate Law may develop and respond to threats (tacit and explicit) to federalize corporate law. See Mark Roe, *Delaware's Competition* (Draft Paper 2003, on file with author); John C. Coates IV & Vikramaditya S. Khanna, *An Analysis of Directorial Liability: Of Enron & Caremark* (Draft Paper 2003, on file with author). Thus, certain measures may be undertaken in Delaware not because they are perceived to be the most efficient, but because if they are not adopted then an even "worse" outcome may eventuate – federalization of the issue at hand. See Roe, *supra*; Coates & Khanna, *supra*; Roe, *supra* note 11. This suggests that changes in state corporate law are acting as substitutes for more costly changes in federal law.

There is also some evidence suggesting that the *judiciary* may rely on substitution too. Some empirical evidence suggests that Federal Judges have started awarding higher sanctions since the Guidelines were adopted even in cases not subject to the Guidelines. See Alexander, et al., *supra* note 50, at 416 – 17. The conjecture is that this may have been a strategic move by the judiciary to head off any more sanction increases or encroachments on sentencing discretion for the time being. See *id.*

⁹⁷ See Pritchard, *supra* note 94, at 2 (noting vigorous opposition exists to the PSLRA but gives no such information on Sarbanes-Oxley).

⁹⁸ See Morton Mintz, *Hill Considers Changing Law on Foreign Bribery*, WASH. POST, Oct. 25, 1987, at H6; SENATE REPORT NO. 114, FOREIGN CORRUPT PRACTICES ACT OF 1977, at 10.

⁹⁹ See SENATE REPORT, *supra* note 98.

¹⁰⁰ See *id.*

¹⁰¹ See *id.*

¹⁰² See Mintz, *supra* note 98.

attempts to permit state attorney generals to bring antitrust suit on behalf of their citizens and then permit follow on private enforcement.¹⁰³ Corporate interests (led by the Business Roundtable) lobbied heavily against this.¹⁰⁴ In the end, the version of the law that was enacted was one that did permit state attorney generals to bring suit on behalf of their citizens, but limited the ability of private attorneys to capture treble damages as well as making it more difficult to garner contingency fees.¹⁰⁵ This is consistent with the notion that corporate interests prefer government enforcement to private litigant enforcement and similarly may prefer corporate crime legislation over increases in corporate civil liability.

This is not to suggest that corporate interests never lobby in the criminal sphere, but that such lobbying tends to be the exception rather than the rule. Indeed, there is evidence that corporate interests do lobby in the criminal sphere when there are large penalty increases being proposed or when criminal liability for directors and officers is likely to increase significantly.¹⁰⁶ These would be instances of where the costs of corporate crime legislation are getting closer to the costs of increases in corporate civil liability and thus the lobbying activity is more understandable. However, outside of these instances we rarely witness much active corporate lobbying against increases in corporate criminal liability.

These instances provide some support for the substitution thesis. Although they are not conclusive support, as other factors may also be relevant, they are consistent with the substitution thesis and do appear to support it.

IV. THE SUBSTITUTION THESIS WHEN THE CONCERN IS MANAGERIAL LIABILITY.

Corporate interests may also prefer corporate crime legislation because of its potential effect on the incidence of managerial criminal liability. This is

¹⁰³ See *Antitrust Advance*, N.Y. TIMES, Jun 17, 1976, at 34; Eileen Shanahan, *Antitrust Bill Stopped By A Business Lobby*, N.Y. TIMES, Nov. 16, 1975, at 1.

¹⁰⁴ See *Antitrust Advance*, *supra* note 103; Shanahan, *supra* note 103.

¹⁰⁵ See *Antitrust Advance*, *supra* note 103. Another similar instance is the lobbying activities of corporate interests surrounding some potential changes in when treble damages might be available in anti-racketeering cases. Corporations lobbied heavily against the treble damages portions, but not too much against the criminal aspects. See Russell Mokhiber, *Triple Damages*, N.Y. TIMES, Sept. 14, 1985, at 23.

¹⁰⁶ For example, when the organizational sentencing guidelines increased corporate criminal penalties we saw corporate interests lobby heavily for smaller increases in penalties and for sanction reductions based on compliance efforts. These efforts were largely successful. See Reynolds, *supra* note 49; Macey, *supra* note 59. Also, when criminal liability for officers and directors may increase we see corporate lobbying efforts that often defeat or restrain attempts to expand this liability. Examples would be proposals to increase such liability at the time of the passage of the Federal Securities Laws. See *The Securities Bill Made Less Drastic; Conferees Ease Responsibility on Directors, bar "Censorship" in Advertising*; SPECIAL TO N.Y. TIMES, May 17, 1933, at 25; Eustace Seligman, *Securities Bill Held Too Strict*, N.Y. TIMES, Apr. 1, 1933, at 23; *Senators Revise Securities Bill*, N.Y. TIMES, Apr. 9, 1933, at N9; *Merchants Protest; New Yorkers Ask for Hearing on the Securities Bill*, N.Y. TIMES, May 9, 1933, at 3; *Attacks Securities Bill; Investment Bankers' Head Calls It Detriment to Industry*, N.Y. TIMES, May 8, 1933, at 29; G.R. Davis, *The Securities Bill; Some Features Viewed as In Restraint of Trade*, N.Y. TIMES, May 22, 1933, at 14.

because corporate criminal liability has the potential to deflect criminal liability away from managers and on to the corporation (i.e., shareholders). For example, having a corporate defendant along with a management defendant in the same case may increase the odds that management escapes conviction or suffers a lesser criminal penalty relative to where management is the only defendant.¹⁰⁷ Corporations and management may prefer this outcome in some instances and the deflection potential may help reduce the incentive of corporations and management to oppose corporate crime legislation. Simply put, corporate criminal liability may substitute for criminal sanctions on management.¹⁰⁸

To discuss this in greater depth let us assume that managers realize that some amount of criminalization of their own behavior is inevitable – the public’s desire for punishment is very large at times and legislators and prosecutors would be hard pressed not to placate that desire.¹⁰⁹ However, if another defendant were present to shift blame to then that might insulate managers somewhat from criminal liability and reduce their opposition to it. For example, let us assume that when management is the sole defendant the likelihood of a conviction is 20%. However, when there is more than one defendant then the likelihood of one of the defendants being convicted increases to say 25%. This is because the decision maker (judge or jury) has more choices of whom to hold accountable which increases the possibility of obtaining a conviction against one of them compared to when you may only proceed against one person.¹¹⁰ However, even though the total likelihood of obtaining a conviction may increase, the likelihood of obtaining a conviction against management may drop as the decision-maker increasingly imposes criminal sanctions on the other defendants too.¹¹¹ Thus, from the manager’s perspective adding another

¹⁰⁷ See John C. Coffee, Jr., “No Soul to Damn, No Body to Kick”: An Unscandalized Inquiry into the Problem of Corporate Punishment, 79 MICH. L. REV. 386, 397-402 (1981); BRICKEY, *supra* note 16, § 3.09, at 115 – 18 (discussing case law upholding corporate convictions when individuals agents were not convicted); Raymond A. Atkins & Jeffrey S. Parker, *Did the Corporate Criminal Sentencing Guidelines Matter? Some Preliminary Empirical Observations*, 42 J. L. & ECON. 423, 441 – 443 (1999); Jeffrey S. Parker, *Doctrine for Destruction: The Case of Corporate Criminal Liability*, 17 MANAGERIAL & DEC. ECON. 381 (1996); Parker, *supra* note 9, at 399 – 400.

¹⁰⁸ The idea here is that the presence of corporate crime legislation reduces the cost of managerial criminal liability and makes it more acceptable to enact – managers are less opposed because they expect that there will be some insulation/deflection from liability.

¹⁰⁹ *Cf.* Roe, *supra* note 11. Moreover, managerial criminal liability may have strong deterrent and expressive functions and this provides further support for it. See A. Mitchell Polinsky & Steven Shavell, *Should Employees Be Subject to Fines and Imprisonment Given the Existence of Corporate Liability?*, 13 INT’L REV. L. & ECON. 239, 239-241 (1993) (arguing that agent criminal liability may be desirable at times). This suggests that since it may be in the public interest at times those who benefit from it would lobby for it and have an advantage in the lobbying process. See Becker, *supra* note 12, at 385.

¹¹⁰ See Coffee, *supra* note 107, at 397 – 402; Atkins & Parker, *supra* note 107.

¹¹¹ See BRICKEY, *supra* note 16, § 3.09, at 115 – 18. When there are both human and corporate defendants the jury/judge may decide to convict the corporation, rather than the manager, as it can place itself in the manager’s position and sending someone with family and high reputation to jail may be more difficult when an alternative defendant, not subject to jail time, is available. See *id.*

defendant might be desirable because the likelihood of management being convicted may drop from 20% to 15% even though the overall likelihood of conviction may increase to 25%.¹¹² The gap may be borne by the additional defendants.¹¹³ The question then becomes: where is one to find a person willing to share or bear most of the blame for other people's wrongdoing? This is where corporate criminal liability may prove helpful.

There is some anecdotal and empirical evidence suggesting that corporate criminal liability results in corporations bearing some of the blame that would otherwise be visited upon management. For example, there is case law about whether a corporate conviction can stand when all the potentially liable agents have been acquitted.¹¹⁴ The answer, perhaps surprisingly, is that the corporate conviction can stand.¹¹⁵ Although the legal rationales for this result are interesting,¹¹⁶ the important point for my analysis is that these cases arise in the first place. This implies that sometimes corporations are being held liable and managers acquitted. One conjectures that this is because juries may empathize more with human defendants than fictional ones. It is, of course, possible that the managers would have been acquitted even if there had not been a corporate defendant along with them, but the presence of these cases raises the specter that managers were acquitted because, at least in part, the decision maker had an alternative defendant to hold liable – namely the corporation (i.e., shareholders).¹¹⁷

¹¹² See *id.*

¹¹³ Prosecutors and Congress would also like this result as the overall rate of conviction rises from 20% to 25% and convictions are important to prosecutors. See Glaeser, et al., *supra* note 64, at 262 – 66 (discussing private career benefits from successful prosecutions); Stuntz, *supra* note 44, at 534; Hylton & Khanna, *supra* note 12, at 18 – 25; Gordon Van Kessel, *Adversary Excess in the American Criminal Trial*, 67 NOTRE DAME L. REV. 403, 442 (1992) (noting that "win-loss records can become an important mark of performance"). One may wonder if prosecutors would prefer to obtain a conviction of a real human being – might that not be worth more than the conviction of a corporation? This is possible, but it depends on what prosecutors are trying to do. If obtaining convictions against management is more difficult than obtaining convictions against corporations then prosecutors might not prefer to substitute a high risk strategy (going after management) at the expense of getting a more certain conviction of a corporation. The fact that prosecutors do bring charges against both the corporation and the individuals (when deflection is a concern) suggests that prosecutors are willing to take the risk of trading off reduced convictions against individuals for an overall higher rate of conviction.

¹¹⁴ See BRICKEY, *supra* note 16, § 3.09, at 115 – 18 (discussing case law upholding corporate convictions when individuals agents were not convicted); GRUNER, *supra* note 7, §3.7.4, at 254 – 58 (same); Ann M. Foerschler, Comment, *Corporate Criminal Intent: Toward a Better Understanding of Corporate Misconduct*, 78 CAL. L. REV. 1287, 1290 (1990) ("In a number of cases in which both were jointly tried for an offense, the jury convicted the corporate defendant and acquitted the individual defendants").

¹¹⁵ See BRICKEY, *supra* note 16, § 3.09, at 115 – 18 (discussing case law upholding corporate convictions when individuals agents were not convicted); GRUNER, *supra* note 7, §3.7.4, at 254 – 58 (same).

¹¹⁶ See BRICKEY, *supra* note 16, § 3.09, at 115 – 18 (discussing case law upholding corporate convictions when individuals agents were not convicted); GRUNER, *supra* note 7, §3.7.4, at 254 – 58 (same). [Discuss reasons for holdings]

¹¹⁷ See BRICKEY, *supra* note 16, § 3.09, at 115 – 18 (discussing case law upholding corporate convictions when individuals agents were not convicted); GRUNER, *supra* note 7, §3.7.4, at 254 – 58 (same);

There are also some indications that the deflection account is a concern recognized by prosecutors. Indeed, the Department of Justice's Principles of Federal Prosecution of Business Organizations state that "prosecutor[s] should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty".¹¹⁸ This concern may also be one factor that has led prosecutors to reduce corporate sanctions (or not charge corporations) when they turn over information on potentially culpable employees.¹¹⁹

Moreover, there is some empirical evidence to which we can refer.¹²⁰ Although this evidence cannot be considered fully persuasive, it is at least not inconsistent with a deflection thesis. The evidence suggests that corporate and individual penalties are coordinated, at least implicitly.¹²¹ If such coordination does occur then that suggests that individual penalties should drop with the presence of corporate co-defendants.¹²² Thus, the empirical evidence suggests it is plausible that when management is the sole defendant the likelihood and magnitude of managerial criminal sanctions is higher than the likelihood and magnitude of managerial criminal sanctions when there is another defendant

Developments, supra note 16, at 1367 – 68 (highlighting the perception that corporations often are convicted and managers are acquitted). One might also view these outcomes as compromise verdicts.

¹¹⁸ LARRY D. THOMPSON, DEPUTY ATTORNEY GENERAL, MEMO ON PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATION, 20 JANUARY, 2003, PART VI, http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm. If these guidelines had their desired impact then the deflection potential would be reduced and may reduce some support for corporate crime legislation by corporations and managers on this front.

¹¹⁹ See U.S. SENTENCING GUIDELINES § 8C2.5(g)(1) (2002) (Fines and/or sentences may be reduced for cooperation with the government) from http://www.uscc.gov/2002guid/8c2_5.htm. (last visited Aug. 3, 2003); also Win Swenson, Deputy General Counsel/Legislative Counsel, *The Organizational Guidelines "Carrot and Stick" Philosophy and Their Focus on Effective Compliance*, <http://www.uscc.gov/SYMPO/WCSYMPO1.HTM#The> (Deputy Director of USSG clarifies § 8C2.5(g)(1) : "[v]oluntary disclosure and cooperation by a company mean, for example, that harms caused by the company will be rectified and individuals within the company will be identified and held accountable."); Laufer, *supra* note 58, at 649 – 52.

¹²⁰ See Atkins & Parker, *supra* note 107.

¹²¹ See *id.* Direct data on the effects of a corporate co-defendant on the other defendants in corporate crime cases appears unavailable due to data constraints at the US Sentencing Commission. See *id.* at 443.

¹²² See *id.* at 443. The evidence of coordinated penalties is consistent with individual penalties declining with the addition of a corporate co-defendant and also with corporate penalties declining with the addition of an individual co-defendant. This raises an interesting "chicken and egg" problem. Do we assume that the former account (individual defendant later joined by corporate defendant) or latter account (corporate defendant later joined by individual defendant) is the correct picture. If the former then the deflection account in the text is at issue, if the latter then a different kind of deflection account is offered – the corporation is avoiding criminal sanctions by shifting some of them to the individual. Both are plausible: the former account because it is the kind of deflection a corporation and management would both support (as it might reduce risk-bearing costs and hence wage bills – see discussion *infra text accompanying notes* 128 - 142). The latter is consistent with a reverse whistleblowing hypothesis where the corporation turns over employees (regardless of whether the employee "ratted out" was actually culpable or simply a scapegoat). See *text accompanying notes* 128 to 142. My goal is not to choose between these accounts because both are plausible, rather my aim is to suggest that the deflection account is plausible.

(such as the corporation).¹²³ Taking this together with the case law and anecdotal evidence suggests that some managers may be avoiding jail time and other criminal penalties because of the presence of corporate criminal liability. In other words, some criminal penalties may be deflected away from management and on to the corporation (i.e., shareholders).¹²⁴

Of course, I do not expect that deflection will occur all the time. For example, if the managers are clearly guilty of wrongdoing and have caused serious harm then deflection is less likely to occur.¹²⁵ Juries are likely to place more blame squarely on management shoulders in such cases. Further, when the corporation is the victim of the wrongdoing (e.g., embezzlement) deflection is less likely to occur because juries may not wish to convict the victim (i.e., the corporation).¹²⁶ Nonetheless, it is plausible (and likely) that deflection occurs in a number of other instances.

¹²³ See *id.* at 443.

¹²⁴ One may wonder about the significance of the deflection account given that the number of criminal prosecutions in the business sphere is rather small. See UNITED STATES SENTENCING COMMISSION ANNUAL REPORT 2001, available at <http://www.ussc.gov/ANNRPT/2001> (last visited Mar. 21, 2003); First, *infra* note 51; Alexander, et al., *supra* note 50, at 403; Davidson, *supra* note 51; Geraghty, *supra* note 51; Murphy, *supra* note 51; Rakoff, *supra* note 51. To be clear, I am not suggesting that deflection is the *cause* of corporate crime legislation or enforcement – only that it may be another factor that softens the cost of corporate crime legislation for business interests when confronted with a Congress that is going to enact something.

On a separate note, over the last 30 years the rate of *civil* suits brought by government agencies has been increasing while criminal suits have stayed nearly constant. See Kenneth Mann, *Punitive Civil Sanctions: The Middleground Between Criminal and Civil Law*, 101 *YALE L.J.* 1795, 1798 (1992); Hughes, *supra* note 32, at 579 – 80; 587 – 89. The reasons for this are fairly simple – corporate civil liability offers the same penalties as and similar or better enforcement tools than corporate criminal liability, but at a lower standard of proof. This raises interesting questions about why prosecutors bring corporate criminal cases at all. For this we need to examine the incentives of prosecutors.

One explanation is that prosecutors consider certain cases particularly egregious and hence decide to pursue them criminally. However, if one casually looks at many corporate criminal prosecutions it is not at all clear that the underlying behavior is all that egregious – sometimes it is and sometimes not. See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1532. The evidence on corporate crime prosecutions at the federal level suggests that most prosecutions are against small distressed corporations which are rarely involved in very harmful wrongdoing and might be considerably easier convictions than targeting larger and more well funded (and defended) publicly traded corporations. See UNITED STATES SENTENCING COMMISSION ANNUAL REPORT 2001, available at <http://www.ussc.gov/ANNRPT/2001> (last visited Mar. 21, 2003); First, *supra* note 51; Davidson, *supra* note 51; Geraghty, *supra* note 51; Murphy, *supra* note 51; Rakoff, *supra* note 51.

Other explanations also abound, such as that prosecutors are actually interested in these cases (e.g., they are interested in acquiring human capital in a field). See Glaeser, et al., *supra* note 64; Richard T. Boylan & Cheryl X. Long, *The Sources of Agency: An Empirical Examination of United States Attorneys* 25 – 27 (Draft paper 1999, on file with author). Although plausible, one expects that there are some constraints on how easily prosecutors can choose cases to simply pad their resumes. See Richman, *Delegation*, *supra* note 40, at 789 – 810 (suggesting some constraints on prosecutors through for example budgetary allocation). It is not clear that any of these motivations would correlate with bringing criminal prosecutions against corporations when it is in the public interest (if ever).

¹²⁵ One presumes juries would be less sympathetic in such a case than when managers are not clearly culpable and where the harm appears to be small. Cf. BRICKEY, *supra* note 16, § 3.09, at 115 – 18.

¹²⁶ Corporations may also be more likely to turn over an agent to authorities in such a situation.

If corporations are sometimes bearing the blame for management behavior because of corporate criminal liability then why might corporations not actively lobby against corporate criminal liability? There are a couple of potential explanations for this: (1) this “scapegoating” does not hurt the corporation and (2) corporations are hurt, but are stymied by agency costs.¹²⁷ Let us examine each one in turn.

Corporate criminal liability could arguably benefit corporations by shifting criminal liability from managers, who are poor risk-bearers, to corporations who are better risk-bearers.¹²⁸ Managers are considered poor risk-bearers because they cannot diversify their investment in the corporation (largely human capital allocated to a single firm) as easily as shareholders can diversify their investment in the corporation (largely monetary capital, which can be allocated to multiple firms).¹²⁹ Consequently, managers need to be compensated more than shareholders for bearing risk (i.e., a risk premium reflected in a higher wage), which may lead corporations (i.e., shareholders) to prefer to bear the risk themselves to reduce their wage bills.¹³⁰ The risk of criminal sanctions is just another risk that managers bear poorly and a risk for which they need to be, at least implicitly, compensated through something like a higher wage.¹³¹ Thus, corporations may prefer to reduce their wage bills by shifting some criminal liability away from managers, but criminal sanctions on managers are often difficult to explicitly indemnify or insure against.¹³² This is where corporate criminal liability might be desirable to corporations: it permits them to shift some liability away from management (and on to themselves) thereby reducing their wage bill.¹³³ This aspect of corporate criminal liability would be even more desirable to corporations if they thought there was over-criminalization of what, in their view, is profit enhancing behavior.¹³⁴

¹²⁷ Cf. generally Jennifer Arlen & Deborah M. Weiss, *A Political Theory of Corporate Taxation*, 105 YALE L.J. 326 (1995). Of course, if the costs of this “scapegoating” are small then it may not pay for corporations to spend resources to oppose it.

¹²⁸ See Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 864 – 67 (1984).

¹²⁹ See *id.*

¹³⁰ See Polinsky & Shavell, *supra* note 89, at 241. The recent increases in penalties under Sarbanes-Oxley appear to have led to increases in directors and officers insurance and to increases in compensation packages for independent directors. See Richard A. Epstein, *Sarbanes Overdose Law and Economics*, NATIONAL LAW JOURNAL, Jan. 27, 2003. See also John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 19 (1986) (noting that corporations end up paying, in the form of higher compensation, for the costs associated with the risk of liability that managers bear).

¹³¹ See Polinsky & Shavell, *supra* note 89, at 241. Also, to the extent that some of the loss suffered by management is in the form of stigma it would be difficult to insure against.

¹³² See 2 WILLIAM E. KNEPPER & DAN A. BAILEY, *LIABILITY OF CORPORATE OFFICERS & DIRECTORS* 446 (6th ed. 1998).

¹³³ See Polinsky & Shavell, *supra* note 89, at 241.

¹³⁴ For the notion that there is over-criminalization see, e.g., Coffee, *supra* note 7, at 210 – 13; Paul H. Robinson & John M. Darley, *The Utility of Desert*, 91 NW. U. L. REV. 453, 470 (1997).

To elaborate, let us consider the following example. Assume that managers face a criminal fine of \$100 for some wrongdoing with a 20% probability when there is no corporate criminal liability.¹³⁵ This means they face an expected sanction of \$20 and also have risk-bearing costs associated with facing the risk of criminal penalties. Let us say these risk-bearing costs amount to an additional \$8. This implies that the cost to managers is \$28 and this would, in some measure, be reflected in the wages paid to managers.¹³⁶ This higher wage would be borne by the corporation and in this sense the corporation bears the costs of managerial criminal liability.¹³⁷

Now consider the alternative of where both corporations and managers can be held criminally liable. In such a scenario assume that the corporation bears the \$100 criminal fine 15% of the time and managers bear it only 5% of the time (due to liability deflection to corporations). Here the cost to the corporation is the 15% of the time it is held liable and the wage increase to management to reflect the 5% risk of criminal liability.¹³⁸ The expected sanctions are then \$15 on the corporation and \$5 on managers. We are then left with risk-bearing costs. The corporation is normally assumed to be risk-neutral because shareholders can diversify their investment in the corporation and this suggests they bear little additional cost above the \$15 expected sanction.¹³⁹ Managers, on the other hand, bear risk poorly and would face some risk-bearing costs.¹⁴⁰ However, managers bear a lesser risk of criminal penalties here than when there is no corporate criminal liability (only a 5% risk of liability here). Thus, their risk-bearing costs should be less and I assume for now that these costs are only \$2.¹⁴¹ This suggests that managers bear costs of \$7 (\$5 plus \$2) and the corporation \$15 for a total of \$22. This is less than the total costs when there is no corporate criminal liability (i.e., \$28). Thus, because the corporation is paying managerial wages and in effect bearing the cost of these liability regimes it would prefer the lower total cost option.¹⁴² In other words, here corporations prefer corporate criminal liability.¹⁴³

¹³⁵ For now I assume this is for some mix of their intentional and unintentional wrongdoing.

¹³⁶ See Polinsky & Shavell, *supra* note 89, at 241.

¹³⁷ See *id.*

¹³⁸ Cf. *id.*

¹³⁹ See *id.*

¹⁴⁰ See Kraakman, *supra* note 128, at 864 – 67.

¹⁴¹ I have assumed that risk-bearing costs decrease linearly. That is, if a \$20 expected sanction generated risk bearing costs of \$8 then a \$5 expected sanction should generate a proportionally smaller amount of risk-bearing costs. Because \$5 is 25% of \$20 I have assumed risk-bearing costs are 25% of \$8 or simply \$2. This assumption is for simplicity – all that is required in some decrease in risk-bearing costs.

¹⁴² Cf. Polinsky & Shavell, *supra* note 89, at 241. The corporation may even find it in its interest to subject itself to an overall greater likelihood of conviction to obtain this risk-shifting. The corporation may bear an overall greater likelihood of liability in two ways. First, when there are two defendants (corporations and manager) the overall conviction rate is higher. See *discussion supra text accompanying notes* 110 - 113. This means that it is possible that the corporation could be convicted 20% of the time (instead of

Finally, let us consider what might happen when deflection occurs and the corporation bears greater costs than benefits from it. Here the corporation may still not actively oppose corporate crime legislation because it might be stymied by agency costs.¹⁴⁴ To see this start by noting that corporations cannot lobby by themselves – it is managers and other agents who lobby on behalf of corporations.¹⁴⁵ However, managers have an incentive not to make the corporation lobby against corporate criminal liability because the presence of corporate criminal liability may benefit managers by reducing the likelihood that they will bear criminal liability, which is difficult to fully shift or insure.¹⁴⁶ Agency costs may then prevent corporations from actively lobbying against corporate criminal liability when there is some deflection.¹⁴⁷

Thus, corporate interests may also consider corporate crime legislation to be a substitute for criminal sanctions on managers. Taking this with the argument that corporate crime legislation may be preferred over enhancements in corporate civil liability (Part III) suggests that when some kind of Congressional response is inevitable then corporate interests may well prefer corporate crime legislation over other more costly alternatives.

15% as in the text) and management could also be convicted 5% of the time – the corporation and associated parties would then bear a greater overall likelihood of conviction (25% of the time). Another way in which corporate liability could increase is that shifting liability away from managers for intentional wrongdoing creates a moral hazard (*see infra text accompanying notes 229 to 235*) which could lead to more managerial wrongdoing and hence more frequent instances of harm which should lead to increased suits against corporations. It is possible that these costs might be worth the reduction in managerial risk-bearing costs in some instances.

It is also noteworthy that corporate criminal liability's deflection effect *cannot* be replicated by corporate civil liability because a corporation facing only civil liability is not available in the criminal proceedings against the manager as an alternative defendant to convict. Also, one could argue that the liability shifting feature of corporate criminal liability could be achieved by permitting insurance or indemnification of managerial criminal liability. I doubt this would occur as insurers (and those who might indemnify or oversee indemnification) are unlikely to offer this for intentional or knowing wrongdoing (the kind most likely at issue here – *see infra text accompanying notes 233 - 235*) due to moral hazard concerns.

¹⁴³ The reasoning here can be used to support the analysis in Part III.F.

¹⁴⁴ *Cf. Arlen & Weiss, supra note 127.*

¹⁴⁵ *Cf. id.*

¹⁴⁶ *See Arlen & Weiss, supra note 127.* For the difficulty in insuring such behavior see KNEPPER & BAILEY, *supra note 132.*

¹⁴⁷ Further support for this can be gleaned from the PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATIONS, *supra note 118*, at 9 – 10 (suggesting that prosecutors be “wary” of corporate pleas that work to shield individuals within the corporation from criminal liability).

In addition to this, there is evidence that corporate interests have lobbied to reduce managerial liability in certain instances while leaving corporate criminal liability essentially untouched. For example, when the Federal Securities Laws were enacted the early drafts of the laws had much greater liability for directors of corporations, but that was pared back after extensive criticism and lobbying. *See The Securities Bill Made Less Drastic; Conferees Ease Responsibility on Directors, bar “Censorship” in Advertising; SPECIAL TO N.Y.TIMES*, May 17, 1933, at 25; Seligman, *supra note 106*, *Senators Revise Securities Bill*, N.Y.TIMES, Apr. 9, 1933, at N9; *Merchants Protest; New Yorkers Ask for Hearing on the Securities Bill*, N.Y.TIMES, May 9, 1933, at 3; *Attacks Securities Bill; Investment Bankers’ Head Calls It Detriment to Industry*, N.Y.TIMES, May 8, 1933, at 29; G.R. Davis, *supra note 106.*

V. INTERESTS OF OTHER PLAYERS

Thus far, I have discussed the likely interests of corporate players, but there are other important players too, such as the general public and victims of crime, Congress, prosecutors, courts and potential defendants. My analysis suggests that their incentives also push towards broader criminalization. When this tendency is combined with the weak corporate opposition to, or perhaps support for, corporate crime legislation then we have a sure recipe for expansion.

A. *General Public and Victims*

Let us start with the general public and victims of corporate crime. They are important as their desire for punishment, especially of the criminal variety, factors into the decisions of the primary players.¹⁴⁸ However, because the general public and victims often may not be familiar with the details of the corporate criminal law and may suffer from collective action problems one would not expect them, as a general matter, to closely monitor the laws and rules promulgated by legislators.¹⁴⁹ Nonetheless, one can treat the desires of the general public and victims as creating the boundaries within which the primary players engage in their behavior.¹⁵⁰

B. *Congress & Legislators*

Next, let us consider the interests of the primary promulgators of the criminal law: Congress and the legislatures. Presumably, legislators would like

¹⁴⁸ See Stuntz, *supra* note 44, at 523 – 27.

¹⁴⁹ See *id.* at 530. For a classic discussion of collective action see MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1965). Also see RUSSELL HARDIN, *COLLECTIVE ACTION* (1982). One also would not expect large groups with disaggregated constituents to lobby that effectively. See JACK L. WALKER, JR., *MOBILIZING INTEREST GROUPS IN AMERICA: PATRONS, PROFESSIONS, AND SOCIAL MOVEMENTS* 66 (1991). See also David M. Hart, *Political Representation Among Dominant Firms: Revisiting the “Olsonian Hypothesis”* (Draft Paper 2002, on file with author); David M. Hart, *Business Is Not an Interest Group (And, By the Way, There’s No Such Thing as “Business”): On the Study of Companies in American National Politics* (Draft Paper 2002, on file with author). On lobbying activities of corporations see generally John M. de Figueiredo & Emerson H. Tiller, *The Structure and Conduct of Corporate Lobbying: How Firms Lobby the Federal Communications Commission* (Draft Paper 2000, on file with author); Stephen Ansolabehere, John M. de Figueiredo & James M. Snyder, *Are Campaign Contributions Investment in the Political Marketplace or Individual Consumption? Or “Why Is There So Little Money in Politics”* (Draft Paper 2002, on file with author); John M. de Figueiredo, *Lobbying and Information in Politics*, Discussion Paper No. 369, John M. Olin Center for Law, Economics & Business, Harvard Law School 2002, available at http://www.law.harvard.edu/programs/olin_center; Stratmann, *supra* note 46; John M. de Figueiredo & Rui J.P. de Figueiredo, Jr., *The Allocation of Resources by Interest Groups: Lobbying, Litigation and Administrative Regulation* (Draft Paper 2002, on file with author).

¹⁵⁰ See Stuntz, *supra* note 44, at 530.

to remain in power or potentially rise into higher office, amongst other things.¹⁵¹ For that to happen they need to please the people they represent – or more simply the voters.¹⁵² Most voters appear to care deeply about crime and criminal legislation, but suffer from the collective action problems described above.¹⁵³ Thus, voters tend to focus more on the *outcomes* of the criminal process and they may pay more attention to the information conveyed through intermediaries (e.g., television news shows) than to the entrails of the law.¹⁵⁴ Thus, to obtain the favor of most voters, legislators are more likely to attempt to generate *outcomes* that voters desire, rather than specific rules, and to take stands, frequently symbolic, that voters find attractive and that fit on the evening news.¹⁵⁵ For example, voters may like to see more convictions (i.e., outcomes), which could be achieved by tightening criminal liability rules to make it easier to obtain a conviction or increasing sanctions because that increases the threat value of trial making it easier to obtain guilty pleas.¹⁵⁶ Voters may also like to know that something is being done about certain behavior that concerns them.¹⁵⁷ The legislature could provide new crimes that may not really change underlying behavior, but may give voters a sense of security that “something is being done”.¹⁵⁸ Professor Stuntz provides an example of such a symbolic measure wherein Congress criminalized “carjacking” even though there were several other criminal provisions which already covered it.¹⁵⁹

C. Prosecutors

The next important institutional player is the prosecutor. In most jurisdictions prosecutors are elected and in some appointed.¹⁶⁰ The elected prosecutors are in a similar position to elected legislators – for them to keep their jobs and rise into higher office they need to keep the voters pleased with them.¹⁶¹ This essentially means they need to bring prosecutions in most cases the public

¹⁵¹ See *id.* at 529. I do not mean to suggest that legislators do not (or could not) have altruistic or public interest ideals – only that an important goal of legislators is to remain or move up in office. This is a fairly standard assumption in the public choice literature. See, e.g., J. Mark Ramseyer, *Public Choice*, in CHICAGO LECTURES IN LAW & ECONOMICS 101 – 02 (ERIC POSNER ED., 2000). Also, staying in office may be an important way of achieving the public interest or altruistic goals that some legislators may possess.

¹⁵² See Stuntz, *supra* note 44, at 529.

¹⁵³ See *id.*

¹⁵⁴ See *id.* at 530.

¹⁵⁵ See *id.* See also Richard McAdams, *An Attitudinal Theory of Expressive Law*, 79 OR. L. REV. 339, 363 (2000) [hereinafter *Attitudinal*].

¹⁵⁶ See Stuntz, *supra* note 44, at 537.

¹⁵⁷ See *id.* at 529.

¹⁵⁸ See *id.* at 530.

¹⁵⁹ See *id.* at 560.

¹⁶⁰ See *id.* at 533.

¹⁶¹ See *id.* See also Glaeser, et al., *supra* note 64, at 262 – 66; Boylan & Long, *supra* note 124. Until now I have been speaking of federal prosecutors, who are not generally elected. I include discussion of elected prosecutors because the effect of their likely interests on corporate crime legislation is similar to that of non-elected prosecutors.

desires.¹⁶² Appointed prosecutors face somewhat similar pressures depending on what they would like to do. If some would like to run for elected office then clearly they will need to bring prosecutions in cases that the general public strongly desires. If some would prefer to move into higher appointed office then they will need to do things that provide the “appointers” with a reason to select them for that office.¹⁶³ This may involve a number of things, but it will almost certainly involve bringing prosecutions in most cases that the general public desires.¹⁶⁴ Further, both kinds of prosecutors would probably have strong desires to win these cases. This is because the public desires not simply prosecutions but also convictions, and because prosecutors have personal benefits from winning suits.¹⁶⁵

At the same time, line prosecutors (not elected or appointed, but rather “hired” prosecutors) would like rules that did not tremendously increase their own workload, amongst other things.¹⁶⁶ These last two concerns – to increase convictions for all prosecutors, but not to increase workloads for line prosecutors – might seem to run counter to each other, but they need not. Prosecutors can obtain both goals if the criminal law applies to a wide range of behavior because

¹⁶² See Glaeser, et al., *supra* note 64, at 261 (noting that decisions to prosecute are often influenced by prosecutors' interest in running for higher office); Stuntz, *supra* note 44, at 533 (noting that “local prosecutors are likely to seek to produce the range of outcomes the public desires”); Peter Krug, *Prosecutorial Discretion and Its Limits*, 50 AM. J. COMP. LAW 643, 662 (2002) (noting that police misconduct prosecution occurs only in high cases of public visibility).

¹⁶³ See Glaeser, et al., *supra* note 64, at 262 – 66 (discussing private career benefits from successful prosecutions). See also Ramseyer & Rasmusen, *supra* note 64, at 71 – 72 (discussing incentives for Japanese prosecutors and judges and how they, along with a tight budget constraint on prosecutors, work to ensure high conviction rates); John C. Coates IV, *Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis*, 41 VA. J. INT'L L. 531, 561 (2001); Gordon Van Kessel, *Adversary Excess in the American Criminal Trial*, 67 NOTRE DAME L. REV. 403, 442 (1992) (noting that “win-loss records can become an important mark of performance”).

Prosecutors could be trying to maximize many different things (e.g., sentences, convictions, publicity, human capital). See Glaeser, et al., *supra* note 64, at 266 – 88 (noting that prosecutors are motivated at least in part by career growth prospects and providing empirical evidence to that effect); Boylan & Long, *supra* note 124, at 25 – 27 (finding with empirical support that Assistant US Attorneys are often motivated by human capital concerns); Richman, *Agents*, *supra* note 45, at 754; William M. Landes, *An Economic Analysis of the Courts*, 14 J.L. & ECON. 61, 63 – 64 (1971) (treating prosecutor's utility as being composed of maximizing expected sentence lengths subject to a budget constraint); Frank H. Easterbrook, *Criminal Procedure as a Market System*, 12 J. LEGAL STUD. 289, 307 (1983) (noting that career prospects and reputation may impact the exercise of prosecutorial discretion). Instead of specifying a prosecutorial utility function I focus on what might be needed by prosecutors to achieve whatever their ends may be. One expects that bringing cases the public desires and obtaining convictions would be useful to most motivations prosecutors may have. See Stuntz, *supra* note 44, at 533 (wishing to keep their jobs, or more up to higher offices, prosecutors' “incentives is to generate the level and distribution of prosecutions that the public wants”); William T. Pizzi, *Understanding Procedural Discretion in the United States: The Limits of Comparative Criminal Procedures as an Instrument of Reform*, 54 OHIO ST. L. J. 1325, 1338 (stating that “prosecutorial decisions in the United States are ‘susceptible to political influences’”).

¹⁶⁴ See Stuntz, *supra* note 44, at 533 – 39; Coates, *supra* note 163, at 561 (noting that “[t]o pass...political muster, appointees are screened to respond to the political preferences of voters”).

¹⁶⁵ See Stuntz, *supra* note 44, at 534; Hylton & Khanna, *supra* note 12, at 18 – 25.

¹⁶⁶ See Stuntz, *supra* note 44, at 535.

then prosecutors have great latitude in bringing cases the public desires.¹⁶⁷ They are also more likely to obtain some kind of conviction as there are so many things with which the defendant might be charged.¹⁶⁸ Further, the breadth of the criminal law helps to reduce prosecutorial workloads.¹⁶⁹ With many crimes applying to essentially the same behavior the prosecutor could charge all the crimes in one trial and thereby increase the expected sanction the defendant faces from going to trial.¹⁷⁰ This makes going to trial less attractive to the defendant and should induce guilty pleas.¹⁷¹ A guilty plea generates less work for prosecutors than trials, yet obtains convictions of some kind.¹⁷² Moreover, even those prosecutors who are interested in entering private practice after their stint in the prosecutor's office would prefer broader criminal law as that provides them with more opportunities to develop expertise and human capital and become more valuable in their future private practice.¹⁷³ Consequently, if prosecutors were to lobby legislators we would expect them to want broader criminal law because it increases the flexibility of their response to public desires, makes it easier to obtain some kind of conviction, helps to build human capital, and it makes it easier to obtain pleas (thereby reducing workloads).¹⁷⁴

Of course, broader criminal law may result in certain behavior that is considered innocuous by the polity being criminalized. If this were true, then voters might react in revulsion at such laws and that may hurt legislators and prosecutors in elections.¹⁷⁵ Consider the attempt at prohibition as an example.¹⁷⁶

¹⁶⁷ See *id.* at 537-8.

¹⁶⁸ See *id.* at 537.

¹⁶⁹ See *id.*

¹⁷⁰ See *id.*

¹⁷¹ See *id.* at 538.

¹⁷² See *id.* at 537.

¹⁷³ On prosecutors incentives to enter private practice see generally Glaeser, et al., *supra* note 64, at 266 – 88 (noting that prosecutors are motivated at least in part by career growth prospects and providing empirical evidence to that effect); Boylan & Long, *supra* note 124, at 25 – 27 (finding with empirical support that Assistant US Attorneys are often motivated by human capital concerns).

¹⁷⁴ See Stuntz, *supra* note 44, at 537 – 38. The investigatory agencies (e.g., the FBI) may have interests that push in the same direction as line prosecutors. More criminalization increases the investigatory agencies' ability to conduct its investigations and may help reduce the work they need to do to gather evidence. Cf. Richman, *Agents*, *supra* note 45, at 767 – 72 (noting that agencies are pressured to devote resources to successful investigations and Prosecutors, who are also motivated to obtain convictions, can influence the agencies' decision-making in which cases to pursue). Prosecutors prefer fewer cases or easier ones – legislatures prefer easier (more convictions). See *id.* If they are able to simultaneously keep their conviction rates up, all prosecutors (elected and line prosecutors) are likely to want to reduce their workloads. See *id.*

¹⁷⁵ See Stuntz, *supra* note 44, at 548 - 49.

¹⁷⁶ Revulsion towards the passage of Prohibition led to, amongst many other things, a repeal a mere 14 years later. See MARK THORNTON, *THE ECONOMICS OF PROHIBITION* (University of Utah Press, 1991). See also Jonathan Barnett, *The Rational Underenforcement of Vice Laws*, 54 RUTGERS L. REV. 423, 433-5 (2002); Donald J. Boudreaux & A.C. Pritchard, *The Price of Prohibition*, 36 ARIZ. L. REV. 1 (1994) (discussing how revenue generated by the tax system had a pivotal impact on the enactment and repeal of prohibition); Gerald E. Lynch, *The Role of Criminal Law in Policing Corporate Misconduct*, 60 LAW & CONTEMP. PROB. 23, 48 (1997).

However, this concern is muted in the American Criminal Justice system due to prosecutorial discretion. Prosecutors need not prosecute *every case* that presents a potential violation of the criminal law.¹⁷⁷ Further, given the desire of most prosecutors to bring suits that the public desires we might expect few prosecutions that would deeply offend public sensibilities.¹⁷⁸ Some may still happen, but we would expect them to be the exception rather than the rule.¹⁷⁹

This also suggests that Congress is insulated in some respects from the costs of over-criminalizing behavior because prosecutors will rarely prosecute unpopular cases.¹⁸⁰ When they do, it appears that the general public is more likely to lay blame at the feet of the prosecutor for an unpopular prosecution rather than at the feet of the legislators.¹⁸¹ Consequently, one would expect that Congress would prefer to err on the side of over-criminalizing (which has little cost given prosecutorial discretion) rather than under-criminalizing or in spending resources to carefully define the limits of the criminal law.¹⁸²

Thus, the combination of the incentives of legislators and prosecutors, along with prosecutorial discretion, suggests that corporate criminal law and criminal law generally should be skewed towards expansion over time.¹⁸³ That is precisely what we witness.

D. Judges

One might inquire whether judges are able to apply the metaphorical “brakes” on this process as they may, presumably, be less subject to the winds of public opinion.¹⁸⁴ After all, many judges are not elected and are rarely blamed for a prosecution not leading to a conviction – that tends to fall on the prosecutor.¹⁸⁵ Further, the professional esteem and culture of the judicial profession may provide judges with some incentive to curtail too aggressive criminalization.¹⁸⁶ In theory this might be, but in reality the structure of the

¹⁷⁷ See Stuntz, *supra* note 44, at 548.

¹⁷⁸ See *id.*

¹⁷⁹ See *id.*

¹⁸⁰ See *id.*

¹⁸¹ See *id.*

¹⁸² See Stuntz, *supra* note 44, at 548 – 49. Even where legislatures have sought to limit discretion, prosecutors have been able to increase their bargaining power. See e.g., Daniel P. Kessler & Anne M. Piehl, *The Role of Discretion in the Criminal Justice System*, 14 J.L. ECON. & ORG. 256 (1998) (noting that replacing indeterminate sentencing laws with determinative sentencing laws has increased prosecutorial bargaining power not only for the specific crime, but also factually similar crimes).

¹⁸³ See Stuntz, *supra* note 44, at 546 – 57. Cf. Phillip Pettit, *Is Political Justice Politically Feasible?*, 5 BUFF. CRIM. L. REV. 427, 430 (2002) (noting the powerful role that popular sentiment plays in the expansion of the law in well-publicized types of crime, in our case corporate crime).

¹⁸⁴ See *id.* at 541.

¹⁸⁵ See *id.* at 540.

¹⁸⁶ See *id.* at 541.

criminal justice system urges against this. First, judges do not often get to determine which cases they will adjudicate.¹⁸⁷ If cases plea out, as most do, then those cases are rarely subjected to serious judicial scrutiny.¹⁸⁸ Furthermore, judges might have other reasons for not aggressively patrolling the boundaries of the criminal law. For example, judges would probably not like to be reversed.¹⁸⁹ If so and if the criminal law is seen as having enough support that it could lead to legislation overturning the judicial outcome then judges might be cautious in overturning such laws.¹⁹⁰ Further, note that the expansion of criminal statutes may tend to constrain the role of the courts because it reduces law creation opportunities.¹⁹¹ Finally, the other judicial doctrines such as vagueness, double jeopardy, and lenity are less effective when there are many fairly precisely written criminal statutes.¹⁹² Thus, even the judges may not halt the trend toward increased criminalization.

E. Potential Defendants

Although this analysis is compelling, it ignores the effect of the corporate criminal law on those subject to it – the putative criminals.¹⁹³ Indeed, as a general matter, corporate interests should be very effective at lobbying for their own interests even in the criminal side.¹⁹⁴ This is due in part to their good organization, ample funding,¹⁹⁵ good access to legislators and ability to lobby “behind closed doors”,¹⁹⁶ and somewhat less stigma associated with business

¹⁸⁷ See *id.*

¹⁸⁸ See *id.* at 567.

¹⁸⁹ See *id.* at 541.

¹⁹⁰ See *id.* at 542.

¹⁹¹ See *id.* at 565.

¹⁹² See *id.* at 528.

¹⁹³ Although not every criminal law is enforced (due to prosecutorial discretion), the risk of enforcement increases as the breadth of criminal law expands. See Richman, *Delegation*, *supra* note 40, at 765 – 66. Also, Richman argues that Congress has not completely abdicated its supervisory role in the criminal justice area and does exercise some supervision through a variety of means including control of budgetary allocations. See *id.*, at 789 – 810.

¹⁹⁴ We have seen, and would expect to see, them mount serious and probably quite effective resistance to laws that harm their interests. See *e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest Group Theory of Delaware Law*, 65 TEX. L. REV. 469 (1987); DANIEL SHAVIRO, *WHEN RULES CHANGE* (2000); Barton H. Thompson, *Tragically Difficult: The Obstacles to Governing the Commons*, 30 ENVTL. L. 241, 248 – 249 (2000); Charles Elson & Robert B. Thompson, *Van Gorkom's Legacy: The Limits of Judicially Enforced Constraints and the Promise of Proprietary Incentives*, 96 NW. U.L.REV. 579, 583 – 85 (2002) (discussing Delaware response to the Van Gorkom decision).

¹⁹⁵ Corporations and industry should be quite effective at lobbying given that they are normally considered well organized, well funded and small enough that collective action problems can be frequently overcome. See, *e.g.*, Becker, *supra* note 12, at 385; Haddock & Macey, *supra* note 26, at 314; Stratmann, *supra* note 46; at 357 – 66; SHAVIRO, *supra* note 194.

¹⁹⁶ Corporations and executives do not need to lobby “openly” for restrictions on white-collar crime – they are perceived to have fairly good access to political forces and need not make their moves too open. *Cf.* Stratmann, *supra* note 46, at 357 – 66; de Figueirido, *supra* note 149. This is bound to reduce or hide the stigma from lobbying for less restrictive white-collar crime.

wrongdoing as compared to regular crime.¹⁹⁷ However, as I have argued earlier, corporate interests have reasons to support or not oppose corporate crime legislation in certain situations (the substitution theses). In light of this, all the primary players' incentives tend to push towards expansion of corporate crime legislation in situations where some Congressional response is inevitable.¹⁹⁸

Corporate crime legislation then appears to be a relatively low cost method of satisfying public desires along with Congressional and Prosecutorial incentives within the constraints imposed by the lobbying activities of management and corporations. Thus, the growth of corporate criminal liability may be understandable from a political perspective.¹⁹⁹ That leaves one final

¹⁹⁷ See Sally S. Simpson & Nicole Leeper Picquero, *Low Self-Control, Organizational Theory, and Corporate Crime*, 36 LAW & SOC'Y REV. 509 (2002); RUSSELL MOKHIBER, CORPORATE CRIME AND VIOLENCE 4-7(1988). See also Darryl K. Brown, *Street Crime, Corporate Crime, and the Contingency of Criminal Liability*, 149 U. PA. L. REV. 1295, 1335 (2001)(arguing that white collar crime civil sanctions, when the activity is also eligible for criminal prosecution, "negates the public view of the conduct as criminally culpable"); Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1793 - 94 (2000)(noting that the violation of various regulatory laws results in little stigma); Robinson & Darley, *supra* note 134, at 481 (1997) (noting that criminalizing regulatory offenses does not attach stigma for violations); Karpoff & Lott, *supra* note 56, at 765 - 67 (finding that regulatory violations appeared to have little effect on share price suggesting little reputational loss associated with such violations).

Other reasons also arise that make corporate interests good lobbyists in the criminal side. Corporations can always argue that it is in some sense unfair for shareholders to pay a criminal fine for something for which they were probably not directly responsible. Also the sheer detail and complexity of white-collar crime legislation and enforcement would make it easier for corporations and executives to craft language that suits them, yet keeps it effectively out of sight of the general public. Cf. Susan P. Shapiro, *The Road not Taken: The Elusive Path to Criminal Prosecution for White Collar Offenders*, 19 LAW & SOC'Y REV. 179 (1985).

¹⁹⁸ Even the enforcement of corporate crime legislation is subject to discussion. Prosecutors may not always have as strong incentives to pursue prosecutions in the white-collar context as in the street crime context because (i) victims of white-collar crime may be more prone to collective action problems, as they are more diffuse or unaware of their injuries, than most victims of "street" crime and because (ii) white collar crime cases tend to be quite complex and difficult to win relative to most street crime cases and prosecutors want convictions. See Richman, *Agents*, *supra* note 45, at 798 (acknowledging prosecutorial incentives to maximize convictions); Byam, *supra* note 39, at 597 (noting "[s]ome corporate offenses have as their 'victims' people unaware of the injury or unaware of the breacher's identity").

¹⁹⁹ I have not discussed the case of the "street" criminal because the focus of this paper is corporate crime legislation. Nonetheless, there do not appear to be too many private interest groups that pipe up in support of the average street criminal or to constrain the breadth of criminalization. Most interest groups in the street crime context appear to target issues of criminal procedure, death penalty issues, and errors in judicial proceedings (e.g., erroneous convictions) rather than over-criminalization. For example, the American Civil Liberties Union (ACLU) tends to favor changes in criminal procedural rules (see ACLU Webpage, at <http://www.aclu.org/CriminalJustice/CriminalJusticeMain.cfm>), which may not be that difficult to work around for prosecutors given the breadth of criminal law. See William J. Stuntz, *The Uneasy Relationship Between Criminal Procedure and Criminal Justice*, 107 YALE L.J. 1, 26, 28 - 29 (1997) (noting that although these constitutional protections favor the defendant, there is still much discretionary power left with a prosecutor); Kessler & Piehl, *supra* note 182. Families Against Mandatory Minimums (FAMM) is a national, non-profit organization composed of prisoners and their families that challenges mandatory minimum sentencing standards (not over-criminalization per se). FAMM Brochure, *What is Famm?*, at <http://www.famm.org/pdfs/fedbroch2.pdf>. There are academics who argue against the trend to over-criminalize, but I am not treating them as a "private interest group" in the sense that the phrase is usually used. See generally Coffee, *supra* note 7, at 234 - 38 (noting that the development of federal criminal law blurs the line between civil and criminal law, resulting in injustice); HERBERT L. PACKER, THE LIMITS OF

issue for discussion: what normative implications might follow? I address this question after the next Part.

VI. ALTERNATIVE EXPLANATIONS AND REFINEMENTS

In this Part I examine an alternative explanation for the growth of corporate crime legislation and then discuss some necessary refinements of the analysis so far.

A. *Battles Between Corporate Interests.*

Another potential explanation for the growth of corporate crime legislation is that this regulation benefits some firms, who would lobby for it, even though it harms other firms.²⁰⁰ For example, regulations could benefit incumbent firms by raising the costs of entering or remaining in business (i.e., raising entry barriers to the market) and thereby deter or impede new entry.²⁰¹

CRIMINAL SANCTION 249 – 364 (1968); Stanford H. Kadish, *Some Observations on the Use of Criminal Sanctions to Enforce Economic Regulations*, 30 U. CHI. L. REV. 423 (1963); Stuntz, *supra* note 44, at 555.

One might query: why are there so few interest groups that lobby against over-criminalization? This may be due to perceptions that those who lobby against criminalization are likely to either stigmatize themselves or identify themselves as potential wrongdoers. See Stuntz, *supra* note 44, at 555; Richman, *Delegation*, *supra* note 40, at 776. Moreover, given prosecutorial discretion we should not expect too many sympathetic defendants with which to lobby against over-criminalization. See Stuntz, *supra* note 44, at 555. .

Furthermore, the putative “criminals” themselves are unlikely to have the resources and social capital needed to lobby for less restrictive criminal laws. See Dennis E. Curtis & Judith Resnik, *Colloquium: What Does it Mean to Practice Law "In the Interests of Justice" in the Twentieth-Century?: Grieving Criminal Defense Lawyers*, 70 FORDHAM L. REV. 1615, 1618 (2002) (noting that “criminal defendants have no powerful lobby at either the state or federal level”); Donald A. Dripps, *Criminal Procedure, Footnote Four, and the Theory of Public Choice*, 44 SYRACUSE L. REV. 1079 (1993) (arguing that “public choice theory suggests an overwhelming preponderance of political incentives favor unrestricted enforcement of criminal law”). Criminal defendants do, however, benefit from criminal defense attorney lobby groups such as the National Association of Criminal Defense Lawyers. See NACDL Webpage, at <http://www.criminaljustice.org>. The defense attorney lobby concentrates its efforts on increased funding of public defense, defending attorney-client privilege, and abolishing the death penalty rather than over-criminalization. It should be noted that not all potential defendants are powerless. The National Rifle Association has successfully blocked a number of attempts to federalize various gun crimes. For example, an effort to close the “gun show loophole” (allowing purchasers to buy guns at gun shows without a background check) was defeated in the House. See H.R. Res. 249 (1999).

²⁰⁰ See, e.g., GORDON TULLOCK, *THE ECONOMICS OF SPECIAL PRIVILEGE AND RENT SEEKING* (1989); DANIEL A. FARBER & PHILLIP P. FRICKEY, *LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION* (1991); Coates, *supra* note 163.

²⁰¹ See SUSAN M. PHILLIPS & J. RICHARD ZECHER, *THE SEC AND THE PUBLIC INTEREST* 22 – 25 (1981); Kroszner & Stratmann, *supra* note 27; Levine & Forrence, *supra* note 27; Mahoney, *supra* note 51; Maloney & McCormic, *supra* note 26; Oster, *supra* note 27; Peltzman, *supra* note 12; Stigler, *supra* note 26.

The regulations could also benefit firms by providing the regulated entities with a state imprimatur of “trustworthiness” because they meet the regulations promulgated by the state. Cf. John C. Coffee, Jr., *Racing Towards The Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002) [hereinafter *Cross-Listings*] (discussing with supporting evidence how the US Securities Laws may serve a bonding role for foreign issuer).

Although this may provide a strong explanation for regulation in general, there are reasons to think this is not that persuasive as an explanation for corporate crime legislation. First, there is evidence, as noted in Part III.A., that although there is *potentially* a large amount of corporate criminal liability, in reality, its imposition is infrequent and may not be a large cost to businesses.²⁰² Moreover, even though the imposition of penalties is more common on smaller businesses than larger ones (supporting the dueling businesses notion) it is still not frequent enough to operate as a real entry deterrent.²⁰³

In addition, there is evidence that small firms (which newer firms tend to be) are sometimes treated better than larger firms. For example, under the organizational sentencing guidelines, smaller corporations (by number of employees) are likely to receive smaller fines compared with similarly situated larger firms.²⁰⁴ Further, the primary method of obtaining a sanction reduction under the organizational sentencing guidelines – the presence of a reasonably effective compliance program – seems to favor smaller firms too. For example, the complexity and completeness of a “reasonably effective” compliance program tends to increase with the complexity and size of the corporation.²⁰⁵ Consequently, smaller firms are expected to have less onerous compliance programs than larger firms to earn a sentence reduction under the guidelines.²⁰⁶ This is not entirely consistent with an entry barrier account.²⁰⁷

²⁰² A total of 238 organizations received fines or restitution in the 2001 fiscal year. See UNITED STATES SENTENCING COMMISSION ANNUAL REPORT: Table 51, available at <http://www.ussc.gov/ANNRPT/2001/table51.pdf> (last visited Nov. 1, 2002).

The paucity of suits also raises doubts about the ability of corporate crime legislation to operate as a real “imprimatur” to others that the firms subject to the regulation are “trustworthy”. For more see *infra* note 201.

²⁰³ See UNITED STATES SENTENCING COMMISSION ANNUAL REPORT 2001, available at <http://www.ussc.gov/ANNRPT/2001> (last visited Mar. 21, 2003); First, *infra* note 51; Alexander, et al., *supra* note 50, at 403; Davidson, *supra* note 51; Geraghty, *supra* note 51; Murphy, *supra* note 51; Rakoff, *supra* note 51. Indeed, most prosecutions are against small distressed firms, which are the least likely to pose a serious entry threat (as they are already about to go out of the market as they are distressed) and unlikely to have the resources to put up a very strong defense. See UNITED STATES SENTENCING COMMISSION ANNUAL REPORT 2001, available at <http://www.ussc.gov/ANNRPT/2001> (last visited Mar. 21, 2003); First, *supra* note 51; Davidson, *supra* note 51; Geraghty, *supra* note 51; Murphy, *supra* note 51; Rakoff, *supra* note 51.

²⁰⁴ See SENTENCING GUIDELINES, *supra* note 6, at §§ 8C2.5(b)(1) - (5).

²⁰⁵ Cf. FEDERAL PRINCIPLES OF PROSECUTION OF BUSINESS ORGANIZATIONS, *infra* note 118, at 6 - 7.

²⁰⁶ See *id.*

²⁰⁷ Moreover, some regulations may even benefit smaller firms more directly. For example, in the securities regulation context smaller issues can avoid a great deal of regulation by relying on a number of exemptions.

This may explain why there appears to be little interest by industry to lobby for regulatory competition. See Coates, *supra* note 163. Regulatory competition is the idea that permitting issuers to choose their own securities law (e.g. US law, UK law), disclose this choice, and then permit trading anywhere would induce regulatory competition between jurisdictions and may in many instances lead to more responsive and efficient regulation. See Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998); Stephen Choi, *Regulating Investors not Issuers: A Market-Based Proposal*, 88 CAL. L. REV. 279 (2000); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice in Note Investor Empowerment*, 85 VA. L. REV. 1335 (1999); Paul G. Mahoney, *The Exchange as Regulator*,

Further, if we wanted to provide a disincentive to enter the market we need not do so by threatening “criminal” liability for corporations. Civil liability would be sufficient as both “criminal” and “civil” liability offer only monetary penalties against corporations and civil liability is more frequent and often larger.²⁰⁸ Greater deterrents to entry could be obtained by simply increasing civil sanctions rather than relying on criminal sanctions. This suggests that the entry barrier thesis provides, at best, only a partial explanation for corporate crime legislation. Other explanations dependent on the dueling businesses notion could also be considered, but they have a similar flavor to them.²⁰⁹ That leaves us with the substitution theses discussed earlier in this paper.²¹⁰

83 VA. L. REV. 1453 (1997); Howell Jackson, *Centralization, Competition, and Privatization in Financial Regulation*, 2 THEORETICAL INQUIRES IN LAW 649 (2001); Howell Jackson & Eric Pan, *Regulatory Competition in International Securities Markets: Evidence from Europe in 1999* (Sept. 18, 2000) (unpublished manuscript, on file with author); Marcel Kahan, *Some Problems with Stock Exchange-Based Securities Regulation*, 83 VA. L. REV. 1509 (1997).

If so, then we would expect to see firms lobbying for just this kind of regulatory competition as that would mean the costs of raising money would decrease under more efficient systems. In spite of this, we do not see much lobbying by businesses in favor of regulatory competition. See Coates, *supra* note 163, at 565 – 61. Why might that be? One reason is that regulation already appears quite responsive to industry concerns. See *id.*

²⁰⁸ In addition, we could rely on threats of criminal liability *against managers* alone to have this entry deterrent effect.

²⁰⁹ For example, it has been argued that the prosecution against Drexel Burnham and Michael Milken for various securities law violations was lobbied for by the corporate and investment banking establishment to impede competition from upstarts like Drexel and Milken. See Fischel & Sykes, *supra* note 46, at 347; DANIEL R. FISCHEL, *PAYBACK: THE CONSPIRACY TO DESTROY MICHAEL MILKEN AND HIS FINANCIAL REVOLUTION* (1995).

Regardless of the merits of this explanation it is somewhat orthogonal to my analysis. Simply put, this account may explain why we have so much regulation and enforcement in the business sphere generally, but not specifically why there is so much *criminal* regulation. For example, even if the Drexel Burnham enforcement took on only a civil flavor the same critiques could have been levied against it. See *id.* at 347 (essentially doing just this). Indeed, we do not need corporate criminal liability to impose monetary costs on the Drexel Burnhams of the world – even enhanced civil sanctions would have a similar effect.

One could instead argue that regulation benefits industry by providing it with an imprimatur of trustworthiness if corporations meet these regulations (and correlatively identifies as “bad apples” those corporations that do not meet these regulations). See Coffee, *supra* note 201; Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 305 - 08 (1976) (defining agency costs as including “bonding” costs). Professor Coffee argues that the US securities laws operate as an assurance of transparent accounting and fairly good disclosure to many foreign issuers and these issuers may cross-list on US markets to convey this assurance to their own or other investors. See Coffee, *supra* note 201. There is some support for this bonding hypothesis and it provides a good explanation of foreign issuers’ behavior and also of the bonding role of securities regulation. See *id.* Might this explain the growth in corporate criminal liability? I have some doubts.

First, compliance with US securities regulation is considered fairly well enforced whereas corporate criminal liability is largely under-enforced. See *id.* (discussing enforcement under US securities laws); UNITED STATES SENTENCING COMMISSION ANNUAL REPORT 2001, available at <http://www.ussc.gov/ANNRPT/2001> (last visited Mar. 21, 2003); First, *infra* note 51; Alexander, et al., *supra* note 50, at 403; Davidson, *supra* note 51; Geraghty, *supra* note 51; Murphy, *supra* note 51; Rakoff, *supra* note 51; GRUNER, *supra* note 7, §1.7.1, at 29 - 36 (noting problems with detection of corporate wrongdoing and enforcement); Hughes, *supra* note 32, at 576 – 80 (noting that a number of new tools in civil enforcement arose in response to problems of enforcement and detection in the corporate crime area). This suggests that the bonding story of securities regulation is based on some truth whereas the bonding story of corporate

B. Some Refinements.

Finally, before embarking on a normative discussion of the substitution theses, a few points are probably worth noting. First, one might wonder if the analysis in this paper may help to explain developments in corporate civil liability. Although there are certain things that might apply to corporate civil liability, one must be cognizant of the fact that civil liability often involves private enforcers. Consequently, we have people who directly benefit financially from expansions in corporate civil liability and hence would favor it. Corporate crime legislation does not appear to have people who benefit so directly and hence we might anticipate weaker overall support from private enforcers.²¹¹

Second, one might wonder whether the presence of corporate *civil* liability might deflect some civil liability away from management. It might, but I suspect

criminal liability is based on illusion in some manner. One expects that the illusory nature of corporate criminal bonding would go unnoticed by those who invest in such corporations.

Second, if we are relying on the bonding story it is not entirely clear why we need corporate “*criminal*” liability for this. We could instead rely on corporate civil liability as the same assets are being put up as a bond – monetary ones (the only ones the corporation itself possesses). Even if we bring into consideration reputational penalties there is little evidence that the reputational penalty from corporate criminal liability is any greater than the penalty from corporate civil liability holding the underlying wrongdoing constant. See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1509.

Also, it is not so clear that foreign companies can opt into US corporate crime legislation as easily as opting into US Securities Laws.

²¹⁰ On a different note, one could argue that criminal law is better for politically motivated prosecutions because often the prosecutor need not show harm and can pursue criminal enforcement in cases where there is little justification for regulation (as there may be no harm) whereas civil cases might be impeded due to this. See Fischel & Sykes, *supra* note 46, at 347 – 48. This, at best, provides only a partial explanation for corporate criminal liability. First, it provides little explanation for instances of criminal regulation where harm is required before an offense arises. Second, it is plausible that in some *civil* cases the government need not show harm either. If the legislature provides for civil sanctions even when there is no harm then the moving party can recover in civil suits even if no harm is caused. Further it is not clear why corporations and management would not oppose corporate criminal liability because of this feature.

²¹¹ Private litigants (especially the plaintiff’s bar) may support civil liability as it may increase their profits, amongst other things. See Toobin, *supra* note 40, at 6 – 11. Private litigants may not display that kind of enthusiasm for criminal liability, which provides them with incidental gains with little enforcement advantages today. *Cf. id.* at 9 (quoting Joseph Grundfest as saying “[t]he last thing that Bill Lerach wants is a bigger budget for the S.E.C. and more lawsuits to sue the people that he’s suing... If the S.E.C. had the resources to go after the problem in a big way, there is a great deal of evidence that suggests they would do a better job with the companies that have really committed fraud, and not pursue cases where the evidence is weaker”). Moreover, civil government enforcement may provide easier access to information than criminal enforcement and its restrictions on access to information and grand jury proceedings. See Rule 6e, F.R.CRIM.PROC. (2003).

Also, corporate civil liability does serve some deterrent and expressive functions and hence may have some support (politically) whereas corporate criminal liability’s claim to deterrent and expressive advantage is weaker. See Khanna, *Corporate Criminal Liability*, *supra* note 8. Political influence will be exerted as long as the deterrent and expressive benefits (as well as “subsidies” in the form of liability payments) outweigh the cost of using political influence. The cost of gaining support, and therefore influence, is reduced when the interest promoted is a popular goal. See Becker, *supra* note 12, at 390, 393; Beny, *supra* note 12, at 22 – 23.

it may not be too often and also it may not matter as much as the deflection associated with corporate criminal liability. Liability shifting via corporate civil liability may be less common because now managers are subject only to monetary penalties, whereas in the criminal side they faced jail time. One might anticipate more reluctance from a judge or jury to impose jail time on managers than to impose a monetary sanction on them.²¹² Correlatively, one would then expect less deflection via corporate civil liability than via corporate criminal liability. Also, managers can be indemnified or insured for civil liability much more easily than for criminal liability.²¹³ This suggests that there is a lesser need for risk shifting via corporate civil liability than risk shifting via corporate criminal liability.²¹⁴

Third, I hasten to add that I *do not* think that corporate criminal liability *initially* arose in order to deflect liability away from management or to substitute for corporate civil liability. Corporate criminal liability initially developed to fill some enforcement gaps.²¹⁵ Indeed, the substitution accounts cannot easily explain the initial development of corporate criminal liability. This is because in the early 1600s managerial criminal liability was virtually non-existent (i.e., no one would benefit from deflection) and the initial instances of corporate criminal liability involved cases where probably no individual defendant would have been available in any event (i.e., public nuisances).²¹⁶ Further, for much of its history corporate criminal liability expanded to fill enforcement gaps created by a non-existent, or not as powerful, public civil enforcement arm.²¹⁷

However, the substitution accounts do provide good explanations for the impressive growth of corporate crime legislation from the late 1800s and early 1900s onwards. By this time the enforcement function served by corporate criminal liability could be met by public civil enforcement.²¹⁸ Moreover, managerial criminal liability and corporate civil liability became increasingly

²¹² See BRICKEY, *supra* note 16, § 3.09, at 115 – 18.

²¹³ See KNEPPER & BAILEY, *supra* note 132.

²¹⁴ See Khanna, *Corporate Criminal Liability*, *supra* note 8. The fact that civil liability has a plaintiff (and attorney) who benefit from the suit (potentially receiving a remedy) creates a group that would lobby for the expansion of civil liability. *Cf.* Toobin, *supra* note 40, at 9. A direct analogue is missing for corporate criminal liability.

²¹⁵ See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1485 – 86.

²¹⁶ See Elkins, *supra* note 33, at 90 – 96. Deflection could only be an explanation once managerial criminal liability became a realistic threat. This is a relatively recent phenomenon compared to corporate criminal liability, which dates back to 1635. See Kathleen F. Brickey, *Corporate Criminal Accountability: A Brief History and an Observation*, 60 WASH. U. L. Q. 393, 401 – 402 (1981) (noting Case of Langforth Bridge, 79 Eng. Rep. 919, 919 (K.B. 1635) as an early instance of corporate criminal liability).

²¹⁷ See Brickey, *supra* note 16, at 410 – 414; Elkins, *supra* note 33, at 90 – 96; Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1480 – 84.

²¹⁸ See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1520 – 31.

realistic options.²¹⁹ This suggests that over the period in which corporate crime legislation grew the most its enforcement function was thin to non-existent and the bases for the substitution accounts were mounting.²²⁰

Finally, it is noteworthy that the US is an outlier in terms of corporate crime legislation compared to the rest of the world. Most other developed nations either have no corporate criminal liability or have a much more restricted form of it compared to the US.²²¹ The divergence on this issue is impressive and raises very interesting questions about why so much regulation in the US takes a criminal form.²²² One response is that some countries, as a philosophical matter, reject the idea of vicarious criminal liability and hence would not countenance corporate criminal liability.²²³ Another response is that if corporate crime legislation is a substitute for other liability strategies (e.g., increases in corporate civil liability and managerial liability) then in countries with small amounts of these other strategies one would not expect much corporate crime legislation. Most other countries have less corporate civil liability and managerial liability than the US and hence corporate crime legislation would have less to substitute for in these other countries.²²⁴ These are both plausible explanations for the divergent treatment we observe in different countries, but other factors may also be at play that merit further study.²²⁵ Indeed, further research into these issues would very be fruitful.

VII. NORMATIVE CONCERNS ASSOCIATED WITH CORPORATE CRIME LEGISLATION

The analysis in this paper raises interesting normative questions and my discussion in this Part sketches my early thoughts on them. I argue that the normative implications of the substitution accounts depend both on the account

²¹⁹ See Hughes, *supra* note 32, at 587 n.37 (stating that it was only in the late 1800s that agencies developed civil enforcement and information gathering powers).

²²⁰ See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1487 – 88.

²²¹ See *id.*, at 1488 – 91; Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *What Works in Securities Laws?*, 22 (Draft 2002, on file with author).

²²² The “over-criminalization” in the US is a matter that has been the subject of much scholarly writing. See Coffee, *supra* note 7, at 210 – 13; Robinson & Darley, *supra* note 134, at 470; Stuntz, *supra* note 44, at 546 – 47. The divergence in approaches is particularly interesting as the empirical evidence suggests that at least the criminal laws targeted to securities laws violations do not appear to help in the development of well-functioning securities markets. See La Porta, et al., *supra* note 221, at 28.

²²³ For example, in Germany and Italy there is no corporate crime legislation because criminal “guilt” can not be found through vicarious liability for fictional entities. See Khanna, *Corporate Criminal Liability*, *supra* note 8, at 1488 – 91 (discussing historical concerns behind this).

²²⁴ See *id.*

²²⁵ Other factors could include other historical and political constraints, the greater prevalence of corporations in every day life in the US, the degree to which entrepreneurial attorneys influence litigation and legislation and so forth. Also, the degree to which the general populace is invested in the securities markets may also influence the vigilance of Congress in regulating the securities markets because problems in those markets are likely to influence many voters. See Pettit, *supra* note 183, at 430 (indicating that areas of law in the public light tend to experience change because public opinion stirs legal changes).

relied upon and on one's priors about the state of the world. For example, let us assume that we believe that corporate crime legislation leads to deflection of liability away from management. Is this normatively good or bad for society? To answer this question let us consider the following example.

Let us assume that to appropriately deter certain corporate wrongdoing we need to impose a penalty of \$5 Million in total on the various corporate participants. Further, it does not matter how liability is partitioned between managers and the corporation if they can bargain cheaply amongst themselves.²²⁶ This is because when bargaining is easy (i.e., transactions costs are low) the parties bargain for the socially desirable outcome.²²⁷ In other words, when bargaining is easy we can, in theory, split liability for \$5 Million in anyway we like and the parties bargain around the liability rule and share liability in the socially desirable manner.²²⁸

However, in reality, transactions costs are rarely zero and there is much evidence that suggests that bargaining between management and the corporation is rarely conducted in an "arm's length" manner.²²⁹ In light of these bargaining problems, where we impose liability does matter because that is where liability is likely to rest. Consequently, we might prefer to place the lion's share of liability on the corporation rather than the manager. This is because corporations (i.e., shareholders) are generally considered better risk-bearers than managers for the reasons discussed earlier.²³⁰ Further, given that society might like to reduce the costs associated with risk-bearing, then placing liability on the better risk-bearer might be the preferred option.²³¹ Consequently, letting liability rest with the corporation seems the desirable outcome and corporate criminal liability facilitates this result in some measure through deflection.

Although convincing, this account is a little too simple. It seems safe to assume that the corporation is better at bearing risk for *unintentional* wrongdoing, but it is not so clear that the same holds for the *intentional or knowing* behavior of management.²³² The reason is a familiar one from the insurance literature.

²²⁶ See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 34 - 35 (1996).

²²⁷ This is an application of the Coase Theorem. See R.H. Coase, *The Problem of Social Cost*, 3 J.L. ECON. 1, *passim* (1960).

²²⁸ See *id.* Many other papers have essentially confirmed this approach.

²²⁹ See, e.g., Lucian Arye Bebchuk, Jesse M. Fried, & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 764 - 74 (2002). I have assumed that the liability is shifted from managers to corporations. If we are dealing with a non-management agent then the contracting concerns might not be as large as when dealing with a management agent.

²³⁰ See Kraakman, *supra* note 128, at 864 - 65.

²³¹ I assume that reducing risk-bearing costs is something that is socially desirable. See, e.g., Polinsky & Shavell, *supra* note 89, at 240 - 41.

²³² Where the wrongdoing is unintentional, management will evade liability by means of the business judgment rule. See *Litwin v. Allen*, 25 N.Y.S. 2d 667 (Sup. Ct. 1940) (holding that management will

Insurance companies do not provide coverage for an insured's knowing or intentional behavior because then the insured would have an incentive to engage in the behavior – to collect the insurance payout.²³³ Analogous problems might arise if we shifted liability for management's *knowing* wrongdoing away from management and on to corporations when bargaining is difficult.²³⁴ This would in effect make the corporation an insurer for the knowing wrongdoing committed by management which reduces management's incentive not to engage in wrongdoing. Thus, deterrence would be compromised relative to where management could not so easily shift liability to the corporation. In other words, shifting liability from management to the corporation through corporate criminal liability for a manager's *knowing* wrongdoing leads to undesirable results (e.g., greater harm caused as managers are less deterred than when more liability is placed on their shoulders).²³⁵

Thus, the normative implications of the deflection thesis depend on whether we think liability is being shifted for unintentional wrongdoing or intentional/knowing wrongdoing by management. In the managerial criminal liability area there are instances of both kinds of wrongdoing,²³⁶ but as a general matter courts tend to require a showing of some *mens rea* before imposing criminal liability on an individual.²³⁷ Thus, it is plausible that, if criminal liability is being shifted from management to the corporation due to corporate criminal liability, then it may be shifted for intentional or knowing wrongdoing. This kind of shifting may be socially undesirable as it impedes deterrence.

Of course, a counter-argument would be to argue that there is too much regulation and criminalization in the business sphere to begin with (i.e., over-deterrence),²³⁸ and thus liability shifting for intentional “crimes” is desirable because it reduces risk-bearing and the “crimes” should not have been “crimes” in the first place. My interest is not in debating which particular state of the

be insulated provided that there is no showing of egregious carelessness). *See also* Joseph Sanders, V. Lee Hamilton, Gennedy Denisovsky, Naotaka Kato, Mikio Kawai, Polina Kozyreva, Takashi Kubo, Michael Matskovsky, Haruo Nishimura & Kazuhiko Tokoro, *Distributing Responsibility for Wrongdoing Inside Corporate Hierarchies: Public Judgments in Three Societies*, 21 LAW & SOCIAL INQUIRY 815, 838 – 39 (1996).

²³³ *See, e.g.*, KENNETH S. ABRAHAM, *DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY* 14-16 (1986); ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW*, 14-15 (1988). Standard issues that might be implicated here are moral hazard and adverse selection. Moral hazard describes an insured individual's potentially decreased incentive to avoid covered costs as well as to mitigate those costs, given that the individual knows that the injury will be covered by insurance. This can lead to potentially higher claim activity and under-deterrence of the group. Adverse selection occurs when higher-risk individuals, aware of their situation, purchase insurance, while at the same time, lower-risk people do not opt for coverage. This occurrence throws off the insurance company's determination of the risk characteristics of a group and leads to more claims than the group, as a whole, would normally produce.

²³⁴ *See id.*

²³⁵ *Cf.* Khanna, *Top Management*, *supra* note 8; Coffee, *supra* note 107, at 408.

²³⁶ *See Developments*, *supra* note 16, at 1259 – 75.

²³⁷ *See id.* *See* BRICKEY, *supra* note 16, at 8.04, 8.29.

²³⁸ *Cf.* Fischel & Sykes, *supra* note 46, at 346 – 48.

world is correct – my point is simply that the normative implications depend on one’s priors about the state of the world. Thus, if we think over-deterrence of managerial behavior is a better description of reality then corporate criminal liability could be desirable if it reduces risk-bearing costs. However, if we think under-deterrence is more likely then corporate criminal liability may impede deterrence by reducing the risk of liability on management for intentional or knowing wrongdoing. In other words, if we think under-deterrence is a problem we might be more inclined to *reduce* corporate criminal liability and rely on other liability strategies such as corporate civil liability and managerial civil and criminal liability instead.

Let us then consider the other substitution thesis – that corporate crime legislation operates as a substitute for enhancements in corporate civil liability. Here, once again, normative implications depend on one’s starting point.

Let us assume that we believe over-deterrence is the problem (too much regulation and criminalization). In such a case, corporate crime legislation might be treated as the more desirable result because, relative to increases in corporate civil liability, it is easier to constrain (given prosecutors’ incentives and resources and budgetary lobbying) and imposes lower social costs. Simply put, corporate crime legislation may satisfy public desires without aggravating the over-deterrence problem as much as increases in corporate civil liability.²³⁹

On the other hand, under-deterrence leads to a somewhat different analysis. If we believe there is too little enforcement of laws regulating corporate wrongdoing then an increase in corporate civil liability may be desirable because it may lead to more enforcement than corporate crime legislation (given prosecutors’ incentives and resources and budgetary lobbying). Thus, relying on corporate crime legislation as a substitute for increases in corporate civil liability may not strengthen deterrence as much.²⁴⁰

This, however, is not the only effect we need to be concerned about. Because corporate crime legislation is more targeted it is more likely to be used in meritorious cases than corporate civil liability and private litigation. However, given that corporate civil liability is composed of both government enforcement and private litigation it is likely to be more numerous and frequent. Thus, corporate criminal liability is probably a more precise tool, whereas corporate civil liability is more frequent. Is the more precise tool better or the

²³⁹ See Roe, *supra* note 11, at 240. For example, corporate criminal liability might have a lesser impact on deterrence than, say, repeal of the PSLRA. Note that from society’s perspective reducing litigation (or targeting it more carefully) through corporate crime legislation would be better than increasing litigation through corporate civil liability when over-deterrence is assumed to be the case.

²⁴⁰ See Lawrence Friedman, *In Defense of Corporate Criminal Liability*, 23 HARV. J. L. & PUB. POL’Y 833, 840 – 41 (2000).

more frequent one for deterrence? There is no simple answer because the deterrent effect of the law depends generally not only on the frequency of its enforcement, but also its accuracy.²⁴¹

The normative implications can then be summarized under two broad headings: over-deterrence and under-deterrence.²⁴² Let us begin with over-deterrence when corporate crime legislation deflects liability away from managers. Here corporate crime legislation is more desirable than other liability strategies because it contains the over-deterrence problem better. Next, let us assume that over-deterrence is the concern and that corporate crime legislation avoids further increases in corporate civil liability. Here again corporate crime legislation is desirable because it contains the over-deterrence problem better.

Now let us focus on the other broad case: under-deterrence. Let us also assume that corporate crime legislation deflects liability away from managers. In this scenario, corporate crime legislation is undesirable because it may lead to under-deterrence of managers. Let us then consider our last case where under-deterrence is the concern and corporate crime legislation avoids further increases in corporate civil liability. Here the analysis seems more ambiguous – corporate crime legislation could be desirable depending on whether precision or frequency of enforcement is more important. One might be inclined to think that increases in corporate civil liability are the better option at present because there have been measures undertaken that appear to have improved the quality of litigation (i.e., led to more meritorious suits), such as the PSLRA.²⁴³

Clearly, the normative implications can be quite complex. What is clear, however, is that those who start from the *a priori* view that corporate wrongdoing is not sufficiently deterred at present may want to argue for *curtailing* corporate criminal liability and increasing the focus on corporate civil liability and managerial liability. For example, if we think the deflection account is accurate and that under-deterrence is a concern then we should want to reduce

²⁴¹ See Louis Kaplow, *The Value of Accuracy in Adjudication: An Economic Analysis*, 23 J. LEGAL STUD. 307, 344 – 69 (1994) (discussing how and why accuracy is valuable in the context of liability determinations); Forrest G. Alogna, *Double Jeopardy, Acquittal Appeals, and the Law-Fact Distinction*, 86 CORNELL L. REV. 1131, 1140 (2001) (arguing that “[g]reater accuracy decreases acquittals of guilty defendants. Public perceptions of inaccuracy and inconsistency in the legal system may lessen the deterrent effect of punishment.”) Michal S. Gal, *Harmful Remedies: Optimal Reformation of Anticompetitive Contracts*, 22 CARDOZO L. REV. 91, 124 (2000) (noting that “[o]nce accuracy increases, the expected sanction for innocent acts disappears. This reduces the extent to which individuals are inefficiently induced to choose the act that does not subject them to the risk of sanctions, and thus stiffer sanctions and lower levels of enforcement can be adopted”).

²⁴² Throughout I will assume that some Congressional response is inevitable in the political climate.

²⁴³ See, e.g., Marilyn F. Johnson, Karen K. Nelson, Adam C. Pritchard, *Do The Merits Matter More? Class Actions Under the Private Securities Litigation Reform Act*, Working Paper No. 02-011, John M. Olin Center for Law & Economics, University of Michigan Law School (Draft 2003), available at <http://www.law.umich.edu/CentersAndPrograms/olin/abstracts/discussionpapers/2002/Johnson%20Nelson%20Pritchard%2002011.pdf> (arguing that the overall quality of suits post-PSLRA has improved).

deflection. We might achieve this by making sure that criminal trials for the managers and corporations are separate. We might also exercise prosecutorial discretion carefully in bringing charges.²⁴⁴ Similarly, those that believe corporate behavior is over-deterred should favor increasing corporate criminal liability, in the assumed political climate, to avoid more costly measures. The counter-intuitive nature of many of these conclusions raises interesting questions about whether it makes sense to regulate the business arena in the method we have.

VIII. CONCLUSION

Corporate crime is a perennial topic of discussion in the legislature, judiciary, academe, business board rooms, and polity at large. The recent spate of corporate wrongdoing has brought corporate crime to the forefront once again and led to the passage of the Sarbanes-Oxley Act of 2002. This legislation adds to the already sprawling and ever increasing area of corporate criminal liability.

However, the continued and rather explosive growth of corporate crime legislation leaves one with a rather strange puzzle: How can such a state of affairs arise? After all, corporations and business interests are considered some of the most powerful and effective, if not *the* most powerful and effective, lobbyists in the country. Yet, we witness the continued expansion of legislation

²⁴⁴ For example, we might bring charges in ways that the deflection potential is reduced and where obtaining information from corporations about its agents is beneficial. Let us assume that there is some probability that managers/agents can be convicted, and that probability increases and approaches one as we obtain more information from the corporation about its managers/agents (assuming they are not simply scapegoats). Here corporate liability (civil or criminal) might generate information about agents that could be beneficial to prosecutors. Further, if the prosecutor uses the information and initiates a case against the manager and does not charge the corporation (or settles relatively soon) then deflection is not a concern as the jury/decision-maker would not have the choice of the corporation, the manager, neither or both. Moreover, if a corporation is not charged then the costs associated with criminal procedural protections (many of which apply at or near trial) are avoided. This provides one scenario in which prosecuting corporations may not be too undesirable at present (unless we can obtain the information about the agent through the application of corporate civil liability at a similar cost).

Another instance is where managers are clearly criminally liable for something quite harmful. Here there is little fear of deflection and also little to be gained from obtaining information from the corporation – as managers are clearly liable. Further, the procedural protections for corporations raise few additional costs over pursuing corporate civil liability because those hurdles would have been cleared in pursuing a manager criminally.

Of course, the other extreme – when no manager/agent can be found liable – is not an instance for corporate criminal prosecution. Although deflection is not a great concern (*ex hypothesi* it is unlikely that any manager/agent could be held liable), there is little benefit from obtaining information from the corporation because managers are not likely, *ex hypothesi*, to be convicted. Moreover, the procedural protections would have an additional cost over corporate civil liability as we cannot “piggyback” off of any managerial conviction(s). Thus, when managers are clearly liable or can be made clearly liable by obtaining information from the corporation then prosecuting a corporation criminally may be not too costly (in the short run). Is this what we witness? This would be an excellent topic for future research.

It is worth noting that no method of exercising prosecutorial discretion can avoid the loss associated with enacting corporate crime legislation instead of something that might be more beneficial to deterrence (e.g. increases in corporate civil liability or managerial liability).

that criminalizes their behavior. What then explains the growth of such legislation?

My analysis suggests that corporate crime legislation may grow because it is a preferred response *for corporate interests* when some Congressional action is inevitable. Most corporate crime legislation arises during a time of a weak economy and around the time that a number of instances of corporate wrongdoing are revealed to the public. This generates a strong desire in the polity for enhanced regulation. Corporate criminal liability's growth could then be explained by the following notions (i) some degree of "punishment" is necessary, as a political matter, to satisfy public desires during recessions when revelations of corporate wrongdoing are numerous, and (ii) corporate crime legislation achieves this while imposing lower costs on business interests relative to other measures that could be undertaken (e.g., increasing corporate civil liability or managerial criminal sanctions). Corporate crime legislation then appears to be a relatively low cost method of satisfying public desires along with Congressional and Prosecutorial incentives within the constraints imposed by the lobbying activities of management and corporations. Thus, the growth of corporate criminal liability may be understandable from a political economy perspective. I hasten to add, however, that these political accounts do not reflect the reasons for the initial development of corporate criminal liability, which came about to fill real enforcement gaps. However, the political accounts do provide some explanations for why corporate criminal liability has grown so much so recently when those enforcement gaps have largely dissipated.

This then leaves a rather important normative question for us: if these political accounts provide an explanation for corporate crime legislation what normative implications follows? My analysis suggests that the normative implications are quite complex and depend largely on one's priors about the world and on which political account(s) one finds persuasive. However, one thing appears clear regardless of the preferred political account(s): if we start with the notion that corporate wrongdoing is not sufficiently deterred at present then we would want to argue for *curtailing* corporate criminal liability and increasing the focus on corporate civil liability and managerial liability.