

# A NEW APPROACH TO CORPORATE CRIMINAL LIABILITY

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## I. THE CURRENT DOCTRINE OF CRIMINAL CORPORATE LIABILITY

It is time to take a new look at the standard for criminal corporate liability. Under current federal common law, a corporation is liable for the actions of its agents whenever such agents act within the scope of their employment and at least in part to benefit the corporation.<sup>1</sup> The theory that has evolved is simple and seemingly logical: a corporation, being merely a person in law only, and not a real one, can act only through its employees for whom it should be held responsible.

But the simple application of vicarious liability principles can have far-reaching effects. Courts applying federal common law have upheld convictions based on vicarious criminal corporate liability even where the agent was acting contrary to express corporate policy<sup>2</sup> and where a bona fide compliance

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1. Remarkably, the Supreme Court has yet to address the appropriate standard for criminal corporate liability. The prevailing standard is one that has been widely accepted by federal appellate court. *See, e.g., In re Hellenic, Inc.*, 252 F.3d 391, 395 (5th Cir. 2001) ("An agent's knowledge is imputed to the corporation where the agent is acting within the scope of his authority and where the knowledge relates to matters within the scope of that authority."); *United States v. 7326 Highway 45 N.*, 965 F.2d 311, 316 (7th Cir. 1992) (holding agent's culpability and knowledge may only be imputed to the corporation where agent was acting as authorized and motivated at least in part by an "intent to benefit the corporation") (citing *United States v. Cincotta*, 689 F.2d 238, 241-42 (1st Cir. 1982)).

2. *See United States v. Basic Construction Co.*, 711 F.2d 570, 573 (4th Cir. 1983) ("[A] corporation may be held criminally responsible for antitrust violations committed by its employees . . . even if, as in *Hilton Hotels* and *American Radiator*, such acts were against corporate policy or express instructions."); *United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1004-07 (9th Cir. 1972); *United States v. Am. Radiator & Standard Sanitary Corp.*, 433 F.2d 174, 204-05 (3d Cir. 1970).

program<sup>3</sup> was found to be in effect. Many of these doctrines were developed in the context of antitrust law,<sup>4</sup> but have since been generalized to other contexts.

As to the limitation that employees must be acting within the scope of their actual or apparent authority, this requirement has been interpreted so expansively that it is practically invisible in many contexts.<sup>5</sup> Similarly, the requirement that an employee act to benefit the company has likewise been relaxed by a permissive interpretation; under the current doctrine, it “is not necessary that the employee be primarily concerned with benefiting the corporation, because courts recognize that many employees act primarily for their own personal gain.”<sup>6</sup> Indeed, such is the state of the modern doctrine of vicarious criminal corporate liability that under federal law, a corporation can be held liable for agents no matter what their place in the corporate hierarchy<sup>7</sup> and regardless of the efforts in place on the part of corporate managers to deter their conduct.<sup>8</sup>

Prosecutors have inordinate leverage due to the current application of the doctrine of vicarious liability. A single low-level employee’s criminal conduct can be sufficient to trigger criminal liability on the part of the corporation. Moreover, it may not even be necessary for the jury to agree unanimously upon the identity of the same criminal employee in order to find the employer guilty.<sup>9</sup> Where such

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3. See, e.g., *United States v. Twentieth Century Fox Film Corp.*, 882 F.2d 656, 660 (2d Cir. 1989) (“We agree with the District Court that Fox’s compliance program, however extensive, does not immunize the corporation from liability when its employees, acting within the scope of their authority, fail to comply with the law and the consent decree.”).

4. See, e.g., *Hilton Hotels*, 467 F.2d 1000; *American Radiator*, 433 F.2d 174.

5. In accordance with traditional agency law principles, the scope of employment is the agent’s apparent, not actual, authority within the corporation. See Joel M. Androphy et al., *General Corporate Criminal Liability*, 60 TEX. B.J. 121, 121-22 (1997) (discussing role of apparent authority in corporate criminal prosecutions). Remarkably, this means that liability flows to the corporation for purposes of *criminal* law even if the corporation has not in fact authorized the agent, so long as a third party believed the agent had apparent authority. See, e.g., *Meyers v. Bennett Law Offices*, 238 F.3d 1068, 1073 (9th Cir. 2001) (upholding liability on the basis of apparent authority in the eyes of a third party); *United States v. Inv. Enters., Inc.*, 10 F.3d 263, 266 (5th Cir. 1993) (“[A] corporation is criminally liable for the unlawful acts of its agents, provided that the conduct is within the scope of the agent’s authority, whether actual or apparent.”); *United States v. Portac, Inc.*, 869 F.2d 1288, 1293 (9th Cir. 1989) (affirming conviction of company based upon illegal actions of agent told by supervisors not to violate the law).

6. Hyewan Han & Nelson Wagner, *Twentieth Survey of White-Collar Crime: Corporate Criminal Liability*, 44 AM. CRIM. L. REV. 337, 342-43 (2007) (citing as examples *Cox v. Adm’r U.S. Steel & Carnegie*, 17 F.3d 1386, 1404 (11th Cir. 1994); *United States v. Automated Med. Labs., Inc.*, 770 F.2d 399, 407 (4th Cir. 1985); and *United States v. Bainbridge Mgmt., L.P.*, Nos. 01 CR 469-1, 01 CR 469-6, 2002 WL 31006135 at \*4 (N.D. Ill. Sept. 5, 2002)).

7. Corporate criminal liability has been predicated on the actions of low-level employees, including salespeople, manual laborers, truck drivers, and clerical workers. E.g., *United States v. Dye Construction Co.*, 510 F.2d 78, 82 (10th Cir. 1975) (superintendent, foreman, and backhoe operator); *Tex.-Okla. Express, Inc. v. United States*, 429 F.2d 100, 102 (10th Cir. 1970) (truck driver); *Riss & Co. v. United States*, 262 F.2d 245, 250 (8th Cir. 1958) (clerical worker); *United States v. George F. Fish, Inc.*, 154 F.2d 798, 801 (2d Cir. 1946) (salesman).

8. See, e.g., *supra* note 3.

9. See *Arthur Andersen LLP v. United States*, No. H-02-121 (S.D. Tex. 2002) (instructing jury that it need not unanimously agree on the same Andersen employee having committed obstruction of justice so long as each juror agreed that an employee obstructed justice), *aff’d*, 374 F.3d 281, 291 n.8 (5th Cir. 2004), *rev’d on other grounds*,

potential liability exists, corporations as a practical matter can rarely afford to take criminal cases to trial because liability can be triggered by such minimal employee conduct.<sup>10</sup>

A prosecutor's leverage is further enhanced because a criminal indictment can have devastating consequences for a corporation and risks the market imposing what is in effect a corporate death penalty or at the very least a significant drop in stock price. The willingness of companies post-Enron to agree to strict deferred prosecution agreements so as to avoid an indictment was greatly enhanced when Wall Street saw first hand the consequences of the decision by Arthur Andersen LLP to reject the government's offer of a deferred prosecution agreement in the winter of 2002. Although the company was at the time hemorrhaging clients and may have likely folded even absent prosecution, the company's decision to face indictment rather than enter into a deferred prosecution agreement was widely viewed as effectively extinguishing any hope of Andersen's continued viability absent an acquittal. Corporate America could see both the resolve of the government to prosecute even the largest of corporations, as well as the consequences that could ensue from a company's refusal to settle.<sup>11</sup> Accordingly, a corporation has little choice but to accede to the government's demands.<sup>12</sup> It is now a commonplace position among the white-collar bar post-Enron—amongst both defense and prosecution—that corporate defense consists largely of being an arm of the prosecutor.<sup>13</sup>

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544 U.S. 696 (2005); *United States v. Bank of New Eng., N.A.*, 821 F.2d 844, 856 (1st Cir. 1987) (applying collective knowledge to criminal corporate liability); *United States v. Shortt Accountancy Group Corp.*, 785 F.2d 1448, 1454 (9th Cir. 1986); *Steere Tank Lines, Inc. v. United States*, 330 F.2d 719, 724 (5th Cir. 1963); *United States v. T.I.M.E.-D.C., Inc.*, 381 F. Supp. 730, 738 (W.D. Va. 1974). See generally Brent Fisse, *Reconstructing Corporate Criminal Law: Deterrence, Retribution, Fault, and Sanctions*, 56 S. CAL. L. REV. 1141, 1189-90 (1983) ("A different approach to *mens rea* is to construct a composite *mens rea* from knowledge possessed by various personnel."); Stacey Neumann Vu, Note, *Corporate Criminal Liability: Patchwork Verdicts and the Problem of Locating a Guilty Agent*, 104 COLUM. L. REV. 459 (2004) (arguing in favor of *Andersen* district court jury charge).

10. See *United States v. Stein*, 435 F. Supp. 2d 330, 381-82 (S.D.N.Y. 2006) (finding attorneys' fee provision of the DOJ Thompson Memorandum unconstitutional, noting enormous power of government to coerce KPMG to adopt policies advocated by the government to avoid prosecution).

11. Typically, commentators argue that the demise of *Andersen* led prosecutors to be more wary of charging corporations, thus leading to an increase in deferred prosecution agreements. See, e.g., Benjamin M. Greenblum, Note, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863, 1875 & n.86 (2005). That analysis is incomplete, however, because it ignores the fact that *Andersen* had been offered and rejected a deferred prosecution agreement. Although prosecutors may be less willing after *Andersen* to indict a large corporation due to perceived collateral consequences and attendant adverse publicity, ironically the reason that corporations are willing to enter into deferred prosecution agreements is because of the belief that a prosecutor is willing to indict even the largest of companies, and the consequences that are believed by corporate management to flow from a corporate indictment.

12. See *Stein*, 435 F. Supp. 2d at 381-82 (finding coercive power of government over KPMG's policies was so great that KPMG's actions could be considered state action).

13. See, e.g., *Interview with David Pitofsky*, 19 CORP. CRIME REP. 46, Nov. 28, 2005, at 14-15 (former federal prosecutor in charge of the Computer Associates prosecution stating, "As of now, prosecutors have immense leverage because conviction can be a corporate death sentence, and they don't want to lose that leverage . . . . One

Rethinking the standard for criminal corporate liability to require the government to show that the company did not have a bona fide compliance program to detect and deter the criminal conduct will serve to correct at least in part the imbalance in power between the government and a corporation facing possible prosecution for the action of an errant employee. Knowing that in the post-Enron world it is the rare corporation that will risk indictment by the Department of Justice, the government has virtually unfettered discretion to exact a deferred prosecution agreement from a corporation, mandating fines and internal reforms. Contrary to the system of checks and balances that pervades our legal system, including the criminal law with respect to individuals, no *systemic* checks effectively restrict the government's power to go after corporations. Grossly disproportionate power may be warranted in situations where the corporation failed to take the necessary steps to prevent the illegality of its employee, since it enables the government to bring a swift and righteous action. But for a corporation that has already put in place the controls which the criminal law would seek to impose, the primary effect of the current system is to render the corporation unable to defend itself and thus powerless in its dealings with a prosecutor who may be misguided or worse.

Corporations like Enron and WorldCom, where fraud was rampant and engaged in by senior management, will never be able to demonstrate that they have taken the measures necessary to prevent and detect crime in their midst. Prosecutors under this proposed revision to criminal corporate liability standards will still wield an enormous stick in dealing with such companies. Moreover, since corporate management will be greatly incentivized to protect the corporation from criminal liability by creating a strong and effective compliance program, the proposed new vicarious liability standard will have the advantage of maximizing the chances that such criminality will not take root in the first place.

For the responsible corporation, the new standard will provide a systemic check on the power of the overly-aggressive, ill-informed, or even unethical prosecutor. For instance, the Citigroup and JPMorgan Chase cases may be examples of situations where this new criminal standard may cause the altered balance of power to lead to more condign results. Both of these major financial institutions entered into settlements with state prosecutors after criminal charges were threatened in relation to the companies' "prepay" transactions with Enron.<sup>14</sup> At the

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of the problems with the process of negotiating a deferred prosecution agreement is that it is not really a negotiation. Any push back by the company on a provision that the government requests is not only going to be shot down, but the government may see it as a reflection that the company's claimed contrition is not genuine."); Joshua R. Hochberg, *The Costs, Benefits, and Risks of Deferred Prosecution Agreements*, WHITE COLLAR CRIME 2006, at 1-2 ("Recent deferred prosecution agreements reflect the government's improved bargaining strength in negotiating corporate settlements. In this era of intense scrutiny of corporate wrongdoing, the government has the ability to impose sometimes onerous settlement terms on companies seeking to avoid criminal prosecution.").

14. The Enron Task Force, established in January 2002 by the Department of Justice (DOJ) to investigate all crimes relating to the collapse of Enron in the winter of 2001, has not been shy to pursue investigations against

announcement of the multi-million dollar criminal and civil settlements, the state criminal prosecutor was reported to say that there was insufficient evidence of criminal conduct.<sup>15</sup> That admission was startling given that evidence of a crime is supposed to be a prerequisite for action by the criminal authorities, and suggests that even institutions as powerful in the financial world as Citigroup and JPMorgan Chase can cave under the pressure to settle to avoid an indictment, even an unjust one.<sup>16</sup>

A standard of criminal liability that cabins government discretion to those cases in which the corporation in fact is guilty of not taking all reasonable action to prevent and detect crime by its employees will lead to more just determinations; it will channel government inquiry toward the relevant criteria for evaluating criminal corporate liability. Notably, because the legal standard for liability informs settlement discussions, where a corporation can effectively show the government that it had an effective compliance system in place at the time of a misdeed, the responsible or wary prosecutor will relent.

Under current practice, apart from evolving DOJ internal guidelines, there is little by way of *systemic* checks on the overly-aggressive, misinformed, or unethical prosecutor. The imbalance in power between the two sides places enormous weight on two things that are both in the exclusive discretion of the government. First, the system counts on the government attorney ethically wield-

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financial institutions that engaged in criminal transactions with Enron. Notably, it passed on the criminal pursuit of Citigroup and JPMorgan Chase, leaving the field open to state prosecutors. *See, e.g.*, Kurt Eichenwald, *Merrill Reaches Deal with U.S. in Enron Affair*, N.Y. TIMES, Sept. 18, 2003, at A1 (outlining Merrill Lynch's deal to avoid prosecution in the wake of the Enron scandal); Kurt Eichenwald, *Canadian Bank Will Pay Fine and Drop Unit in Enron Accord*, N.Y. TIMES, Dec. 23, 2003, at C1 (detailing the Canadian Imperial Bank's deal with prosecutors concerning its role in the Enron scandal).

15. *See* Editorial, *Enron's Friends in Need*, N.Y. TIMES, July 31, 2003, at A24 ("Robert Morgenthau, the Manhattan district attorney, said that he could not prove a criminal case because it would have been hard to demonstrate that any individual banker had acted with intent to commit fraud. Moreover, many of the transactions between the banks and Enron were technically legal."); Kurt Eichenwald & Riva D. Atlas, *2 Banks Settle Accusations They Aided in Enron Fraud*, N.Y. TIMES, July 29, 2003, at A1 (reporting deals made with JP Morgan Chase and Citigroup made to "settle accusations that they aided Enron in misrepresenting its true financial condition for years before the company collapsed").

16. Examples of corporate acquiescence to terms that go well beyond what would appear to be justified by the alleged criminal conduct are starting to abound in the post-Enron era. For instance, in the deferred prosecution agreement between the government and the New York Racing Association, Inc. (NYRA), the government required NYRA to either install slot machines itself or make "commercially reasonable" efforts to subcontract the work. The slot machine revenues were expected to fund court-mandated improvements in public education. Thus, by conditioning dismissal of the indictment on installing slot machines, the agreement went beyond reforming NYRA and implemented state public policy. *Crime Without Conviction: The Rise of Deferred and Non Prosecution Agreements*, CORP. CRIME REP., Dec. 28, 2005, <http://www.corporatecrimereporter.com/deferredreport.htm> (summarizing the NYRA deferred prosecution at paragraph 10). For examples of other deferred prosecution agreements, see generally *id.* (summarizing Bristol-Myers Squibb deferred prosecution agreement); *Interview of Mary Jo White*, 19 CORP. CRIME REP. 48, Dec. 12, 2005 at 14-15 (reporting that prosecutor in Bristol-Myers Squibb case insisted on corporate sponsorship of endowed chair at his alma mater); *Interview of David Pitofsky*, *supra* note 13 (reporting that Oklahoma WorldCom prosecutor sought additional jobs in exchange for deferred prosecution agreement).

ing her power and not threatening indictment simply to coerce a favorable settlement. Save for her personal integrity, a prosecutor may seek to charge for improper reasons, such as personal or political advancement, or exact sanctions that are unwarranted, such as fines disproportionate to the harm. Second, even in the normal circumstance where a prosecutor believes she is acting ethically, the system places great weight on the prosecutor getting it right both in terms of the assessment of the facts and the legal consequences to the corporation that should result from those facts. There are few systemic checks on those government determinations.

## II. RETHINKING CRIMINAL CORPORATE LIABILITY

Wholesale adoption of vicarious liability agency principles flies in the face of the precepts that govern criminal liability. Curtailing the current practice of imputing the acts and intent of an employee to the employer finds support in the traditional goals of the criminal law as well as in Supreme Court interpretations of certain civil statutes, which has led, remarkably, to a narrower interpretation of corporate vicarious liability in certain civil contexts than in criminal cases. Notably, since the Supreme Court has yet to address the proper scope of vicarious liability in criminal corporate cases, examining the first principles of the criminal law and Supreme Court precedent in civil cases is particularly appropriate in assessing the current scope of criminal corporate liability articulated by the federal appellate courts.

### *A. Deterrence and Retribution in Criminal Corporate Liability*

None of the traditional goals of the criminal law or its basic concern for individual determinations of guilt supports the application of agency principles of vicarious liability where a corporation has taken all reasonable measures to conform its employees' conduct to the law. Criminal law, after all, is reserved for conduct that we find so repugnant as to warrant the severest sanction. The goals of the criminal law are to deter and punish such conduct.<sup>17</sup> Where nothing more can

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17. See generally *Developments in the Law—Corporate Crime: Regulating Corporate Behavior Through Criminal Sanction*, 92 HARV. L. REV. 1227, 1235 & n.16 (summarizing goals of criminal law); KATHLEEN F. BRICKEY, *CORPORATE CRIMINAL LIABILITY* §2 (Clark Boardman Callaghan 2d ed. 1992) (providing general background on the evolution of corporate criminal liability); RICHARD S. GRUNER, *CORPORATE CRIME AND SENTENCING* § 2.3.6 n.121 (The Michie Company 1994) (stating that as a general matter “[f]ederal law identifies offender reform and the specific deterrence of offenders as primary goals of criminal sentences for offenders including corporations”); Albert W. Alschuler, Comment, *Ancient Law and the Punishment of Corporations: Of Frankpledge and Deodand*, 71 B.U. L. REV. 307, 312 (1991) (positing retributive justification for corporate criminal liability).

Restitution to victims of crime has also been identified as a purpose of criminal sentencing. Congressional statutes and the U.S. Sentencing Guidelines both provide for restitution. See 18 U.S.C. § 3553(a)(7) (2003) (listing restitution as one of seven factors with respect to determining a particular sentence); 18 U.S.C. § 3663 (2000 & Supp. 2006) (describing restitution provisions); U.S. SENTENCING GUIDELINES MANUAL §§ 5B1.3, 5D1.3

be expected of a corporation than actions it has already undertaken, the goals of the criminal law are satisfied.<sup>18</sup>

Deterrence traditionally is broken down into two components, specific and general. Specific deterrence refers generally to incapacitating the criminal to prevent or dissuade future conduct in that individual. For a real person, that incapacitation comes usually in the form of imprisonment. It can also include restrictions on one's liberty and even employment during a period of supervised release.<sup>19</sup> Prison of course is not an option for a corporation. Specific deterrence of a company could, however, take the form of causing the dissolution of the company (the equivalent of a corporate death penalty), barring the company either permanently or for a period of time from engaging in certain businesses, or subjecting the corporation, like an individual, to a probationary period during which its conduct is restricted and monitored by a court.<sup>20</sup>

General deterrence refers to the effect punishment of a specific defendant will have on other members of society who might be tempted to engage in similar conduct. Such deterrence is thought to work particularly well in connection with white-collar offenses and less well to deter crimes of passion, in which a criminal is thought likely to engage without much forethought to the punishment meted out to similarly-situated individuals. General deterrence is particularly apt with respect to corporate criminal conduct, which tends to be the antithesis of crimes of passion. Corporations—through boards, inside and outside counsel, and formal deliberative processes—generally pay particular attention to precedent in determining the risks and rewards of contemplated action.<sup>21</sup>

The criminal law also serves a retributive function by punishing the offender for

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(2005) (specifying restitution as a mandatory condition of probation and supervised release). Restitution, of course, is a goal of sentencing only if there is a criminal violation. An effective corporate compliance program can assure that restitution is given to victims of corporate crime.

18. Commentators opposed to criminal corporate liability at times resort to theories within the framework of existing criminal law concepts, a practice that is not particularly useful. See Charles J. Walsh & Alissa Pyrich, *Corporate Compliance Programs as a Defense to Criminal Liability: Can a Corporation Save Its Soul?*, 46 RUTGERS L. REV. 605, at 689 (arguing that criminal liability should involve an examination of the “corporate consciousness” to determine if the employee’s conduct is consistent with the corporation’s “rational choice to do right or wrong”). Rather than try to divine the “intent” of a corporation, which can be fraught with problems due to the difficulty of determining what statements and conduct “speak” for the company, a more useful analysis would focus on deterrence and retribution, the first principles of criminal law, to determine whether some aspect of the corporation’s past conduct justifies imposition of vicarious liability under the criminal law.

19. See 18 U.S.C. §§ 3551(b), 3554-3556, 3563, 3583, 3601 (2000 & Supp. 2006) (outlining sentencing, restitution and probation conditions).

20. See 18 U.S.C. § 3551(c) (2000) (applying fine and probation sentencing provisions to organizations); 18 U.S.C. § 3563(b)(22) (2000) (providing courts discretion to require organizations to “satisfy such other conditions as the court may impose”).

21. It is precisely for this reason that criminal laws can be enacted in order to regulate an industry, although this is not commonplace. In certain highly regulated industries, criminal laws serve as a means of regulation. See, e.g., *United States v. Park*, 421 U.S. 658, 673 (1975) (holding FDA misdemeanor statute does not require traditional proof of wrongful conduct); *United States v. Dotterweich*, 320 U.S. 277, 280-81 (1943) (indicating FDA misdemeanor statute is an increasingly prevalent example of penalties being used to regulate).

transgressing society's starkest boundary between what it has determined to be "right and wrong" or "good and evil." It is perhaps this retributive attribute that is most elusive yet most significant to the public. What actions are deemed to be "criminal" is a judgment by society as to what is out of bounds of acceptable societal behavior. The transgression of that boundary is itself a harm that society has determined warrants its harshest condemnation. The boundary is a societal construct, as is the degree of punishment that is warranted for exceeding that boundary.

The corporation that transgresses that boundary can be as subject to retribution as an individual. Nevertheless, there is a difference between corporate and individual retribution. Individual criminality involves basic precepts involving an assessment of individual intent, action, and voluntariness. For a corporation, criminality is a harder construct. When a corporation is held *criminally* responsible for the criminal actions of an employee, retribution requires us to first determine what it is that the corporation did or did not do that warrants criminal sanction. Where an employee has been encouraged to engage in the crime by the corporation the analysis is simple. But what of the company that did everything it reasonably could to prevent such conduct? What then? Should civil damages suffice, or is there some action or inaction by the company that nevertheless is deserving of criminal condemnation?

Imposition of corporate liability where a corporation has taken all reasonable steps to deter and detect the criminal conduct of its employee furthers none of the goals of the criminal law. Such a corporation does not need to be specifically deterred. Indeed, by definition the company has already instituted the programs and policies that the criminal justice system could properly seek in the event of conviction on its own. By the same token, general deterrence would not be served. If anything, the conviction would send to corporations with effective compliance programs the opposite message—that no good deed will go unpunished. In short, there is nothing to deter, generally or specifically. For much the same reasons, there is no valid retributive value in punishing a corporation in such circumstances. Where an individual corporate employee has transgressed, but done so in spite of all reasonable steps by the corporation to prevent such criminal conduct, the culpability of the corporation is non-existent.

Where, as in Enron or WorldCom, a corporation's senior management engages in crime that enables the company to generate artificial earnings to meet Wall Street expectations, or where an executive fudges the numbers in a quarter while management closes its eyes to what is occurring, the company has either actively encouraged crime or tolerated it since it redounded to the company's immediate economic benefit. In either situation, it is doubtful that the company had an effective compliance program, since the encouragement of criminality or willful blindness by senior management would be show-stoppers. In such cases, the company should be held responsible for the conduct of its employees because it has not taken the necessary steps to prevent and detect such crimes from occurring.

By its corporate policies, or lack thereof, the company demonstrates that it is willing to encourage or at least condone criminal conduct that redounds to the benefit of the corporation.

Where, on the other hand, criminality within the corporation is not systemic or condoned, but actively discouraged, current law still allows criminal prosecution. Suppose, for example, in anticipation of an imminent grand jury subpoena, a lower-level executive and a few of her assistants at her direction destroy documents that the employees believe would hurt themselves and the company. Suppose also that the corporation has extensive programs and policies in place to prevent such activity, but that the employees nevertheless committed the crime and were soon found out and turned over by the company to the government. The corporation has taken all reasonable measures to prevent and detect such criminal action by its employees, and nothing beneficial is gained by allowing criminal liability to attach. From a retributive perspective, the main thing that the corporation has done wrong is hiring someone who ultimately committed a crime. But it is hard to understand why the mere employment of one who commits a crime, absent unusual facts such as a complete abdication of screening for clear risk signs, would trigger the sanctions of the *criminal* law. Notably, the DOJ—which is charged with enforcement of the federal criminal laws—and the Sentencing Commission have not taken the Draconian view that mere employment is sufficient to warrant criminal prosecution.<sup>22</sup> Indeed, even the SEC in connection with civil actions and remedies has rejected such a severe position.<sup>23</sup> The DOJ and SEC positions make sense: if one cannot fathom what else a company could reasonably have done to prevent and detect the employee's criminal action, why is criminal liability—society's harshest sanction—appropriate?

In assessing the need for deterrence and retribution, a corporation is fundamentally different than an individual in an important and overlooked respect that warrants limiting imposition of criminal liability for the actions of employees. Companies, unlike most individuals, cannot control absolutely the people's conduct for which they can be criminally liable. It is commonplace that the criminal law's moral basis is called into question whenever individuals with no practical ability to comply with its obligations are punished for their actions. Indeed, this is one of the most basic tenets of modern theories of the insanity defense, and its logic is instructive in the corporate criminal context.

Many U.S. jurisdictions have adopted a two-pronged approach to the insanity

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22. Memorandum from Larry D. Thompson, Deputy Att'y Gen., to Heads of Department Components and United States Attorneys, Principles of Federal Prosecution of Business Organizations VII.B (January 20, 2003), available at [http://www.usdoj.gov/dag/cftf/business\\_organizations.pdf](http://www.usdoj.gov/dag/cftf/business_organizations.pdf) [hereinafter Thompson Memorandum]; U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(a) (cautioning that the fact that a crime occurs does not "necessarily mean that the program is not generally effective").

23. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934, Exchange Act Release No. 44,969, Accounting and Auditing Enforcement Act Release No. 1,470, 76 SEC Docket 220 (Oct. 23, 2001).

defense that takes into account both the moral understanding of the accused *and* her ability to control her actions to conform to the law. The oldest manifestation of this in American law is the irresistible impulse defense that has been referenced in state court decisions at least as far back as the mid-nineteenth century.<sup>24</sup> Jurisdictions following the irresistible impulse rule recognized the fallacy of convicting defendants who, “by reason of the duress of such mental disease . . . had so far lost the *power to choose* between the right and wrong, and to avoid doing the act in question, as that his free agency was at the time destroyed.”<sup>25</sup> In the mid-twentieth century, two new ways of thinking about the insanity defense emerged, each emphasizing that volition is a necessary precursor to the imposition of criminal liability. The first was Judge Bazelon’s short-lived but oft-discussed test, announced in *Durham v. United States*,<sup>26</sup> providing that “an accused is not criminally responsible if his unlawful act was the product of mental disease or mental defect.”<sup>27</sup> The second—and ultimately more influential—was the Model Penal Code’s approach, which put volition and cognition side-by-side for purposes of a criminal insanity defense, stating that a “person is not responsible for criminal conduct if at the time of such conduct as a result of mental disease or defect he lacks substantial capacity either to appreciate the criminality [wrongfulness] of his conduct or to conform his conduct to the requirements of law.”<sup>28</sup>

When defendants, because of a mental illness, lack the ability to conform their conduct to the law, there is simply no moral basis for punishing them.<sup>29</sup> As the Second Circuit stated when it became an early adopter of this test: “Society has recognized over the years that none of the three asserted purposes of the criminal law—rehabilitation, deterrence, and retribution—is satisfied when the truly irresponsible, those who lack substantial capacity to control their actions, are punished.”<sup>30</sup>

A corporation that has taken all practical efforts to prevent the conduct that forms the basis of a current criminal charge is similarly lacking in volition. Indeed,

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24. See Jodie English, *The Light Between Twilight and Dusk: Federal Criminal Law and the Volitional Insanity Defense*, 40 HASTINGS L.J. 1, 16 (1988) (“*State v. Thompson*, decided in 1834, was the first reported use of a control formulation.”). See generally Benjamin B. Sendor, *Crime as Communication: An Interpretive Theory of the Insanity Defense and the Mental Elements of Crime*, 74 GEO. L.J. 1371, 1383–85 (1986) (tracing the history of the irresistible impulse test).

25. *Parsons v. State*, 2 So. 854, 866 (Ala. 1887) (emphasis in original).

26. 214 F.2d 862, 874–76 (D.C. Cir. 1954), *overruled by* *United States v. Brawner*, 471 F.2d 969, 991 (D.C. Cir. 1972) (eliminating the *Durham* rule but retaining lack-of-volition as a basis for an insanity defense).

27. *Durham*, 214 F.2d at 874–75.

28. MODEL PENAL CODE § 4.01 (Proposed Official Draft 1962) (alteration in original).

29. See Richard J. Bonnie, *The Moral Basis of the Insanity Defense*, 69 A.B.A. J. 194, 196 (1983) (“Few people would dispute the moral predicate for the control test—that a person who ‘cannot help’ doing what he did is not blameworthy.”); See Sendor, *supra* note 24, at 1383–85 (“The psychological perspective underlying these [the insanity defenses] is that some insane people lack the degree of self-control necessary to choose not to commit criminal acts.”).

30. *United States v. Freeman*, 357 F.2d 606, 615 (2d Cir. 1966).

the DOJ has recognized this principle that a corporation cannot control every action of their employees and that they consequently should not be held responsible for all such actions. In each and every deferred prosecution agreement with the DOJ since the fall of Enron in late 2001, the DOJ has included a provision that evidences its recognition of the unjust nature of strict vicarious liability. In the typical post-Enron deferred prosecution agreements, the defendant company agrees to a statement of facts and also agrees that it will not contradict that set of facts, through any of its employees or other agents. An employee's statement contradicting the agreed-upon statement of facts can be imputed to the defendant company and constitute a breach of the agreement. Notably, however, if an employee does contradict the statement of facts the company has a set period of time—typically forty-eight to seventy-two hours—to repudiate the statement of the employee and thus cure any breach.<sup>31</sup>

Such a caveat recognizes the basic fact that an organization and an individual are different for purposes of imposition of criminal liability—an organization cannot control the actions of its employees in the manner that an individual typically can control her own actions. Accordingly, even the DOJ has adopted in these agreements a provision recognizing that a corporation can only do so much and that imposition of criminal liability is inappropriate where the company has done all that it can reasonably be expected to control the conduct of its employees. In the case of a deferred prosecution breach, all that DOJ requires not to hold the company vicariously liable for the employee's conduct is repudiation after the fact.

Where a company has already instituted effective mechanisms that reasonably deter and detect crime by its employees, the goals of criminal corporate law are satisfied. Indeed, guidance for such compliance programs can be gleaned from a series of corporate settlements of criminal investigations post-Enron. In those settlements, the DOJ has required as part of deferred prosecution agreements a series of internal reforms. Those agreements set forth a variety of specific and general measures that the DOJ believes are warranted for companies whose employees committed crimes.<sup>32</sup>

Where a corporation, internalizing the guidance in such agreements, has already effectively implemented the measures imposed by the DOJ deferred prosecution

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31. See, e.g., Deferred Prosecution Agreement ¶ 3, *United States v. N.Y. Racing Ass'n*, Cr. No. 03-1275 (E.D.N.Y. Dec. 11, 2003), available at <http://www.corporatecrimereporter.com/documents/nyra.pdf>; Agreement Between Symbol Technologies, Inc. and the U.S. Attorney's Office for the Eastern District of New York ¶ 16 (June 3, 2004) [hereinafter Symbol Agreement], available at <http://www.corporatecrimereporter.com/documents/SymbolAgreement.FINAL.wpd.pdf>; Letter from Leslie R. Caldwell & Andrew Weissmann, Enron Task Force, Dep't of Justice to Gary Naftalis, Counsel to Canadian Imperial Bank of Commerce ¶ 8 (Dec. 22, 2003) [hereinafter CIBC Letter], available at <http://www.corporatecrimereporter.com/documents/cibc.pdf>; Letter from David N. Kelley, U.S. Attorney, S. Dist. of N.Y., to Robert S. Bennett, Attorney for KPMG LLP, Deferred Prosecution Agreement ¶ 15 (Aug. 26, 2005) [hereinafter KPMG Letter], available at [http://www.corporatecrimereporter.com/documents/kpmgdeferred\\_000.pdf](http://www.corporatecrimereporter.com/documents/kpmgdeferred_000.pdf).

32. For a detailed description of the requirements in such agreements, see *infra* Part III.B.

agreements at the time of the criminal conduct by an employee—or other measures that adequately address risk for a particular company—then the goals of the criminal law have been satisfied. After all, the DOJ is the lead agency responsible for enforcing compliance with the criminal laws. Where a company has already implemented the measures that the DOJ itself has viewed as demonstrating responsible corporate behavior, then the purpose for criminal action has been negated.

### *B. Civil Law Limitations on Corporate Vicarious Liability*

One of the more surprising phenomena in current corporate liability law is the unexpected variance between criminal corporate liability and civil corporate liability. Although one might imagine that corporate liability might be broader in civil cases than criminal ones, in fact the opposite at times is true. This is not a result of design: the Supreme Court has yet to wrestle with the parameters of criminal corporate liability in the modern era and consequently determine what limits should be placed on agency principles. By contrast, the Court has tackled, albeit in preliminary steps, the issues posed by application of strict agency principles in the civil corporate liability context.

As we have seen, corporations are currently criminally liable under a vicarious liability analysis. The requirements are clear and simple: if an employee has committed a criminal act within the scope of her employment and intended at least in some measure to benefit the company, then the acts and intent of the employee can be imputed under agency principles to the company. And that is true no matter how many company policies are in place to thwart such criminal conduct, no matter how large the company, and no matter how low the employee is in the corporate hierarchy.

The Supreme Court has, however, not adopted such an approach for all civil corporate liability. In a series of Title VII sexual harassment hostile workplace cases, the Court has counterbalanced the need for employers at times to be liable for supervisor misconduct, with the purpose of Title VII and the desirability of encouraging an employer to prevent the harm prohibited by the statute.<sup>33</sup> Notably, the Court found an employer's affirmative defense to be warranted by the purpose of the statute. Thus, if an employer could demonstrate by a preponderance of the evidence that it had taken "reasonable care to prevent and correct promptly" any harassment and that the plaintiff unreasonably failed to mitigate any harm, then the employer would establish the affirmative defense.<sup>34</sup>

The Court acknowledged but downplayed Title VII's purpose to make victims

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33. See *Penn. State Police v. Suders*, 542 U.S. 129, 145-146 (2004) (re-affirming affirmative defense established in *Ellerth-Faragher* cases); *Burlington Indus., Inc. v. Ellerth*, 524 U.S. 742, 764 (1998) (establishing affirmative defense in sexual harassment cases under Title VII); *Faragher v. City of Boca Raton*, 524 U.S. 775, 806-08 (1998) (same).

34. See sources cited *supra* note 33.

whole. Instead of serving as a means to redress individual grievances, the statute's primary purpose, the Court held, was to influence behavior to "avoid[] harm."<sup>35</sup> The Court found that an affirmative defense would advance this purpose by providing employers an incentive to prevent and correct harassment and consequently serve to further the government's enforcement efforts. In *Suders*, for instance, the Court noted that:

[T]ying the liability standard to an employer's effort to install effective grievance procedures would advance Congress' purpose to promote conciliation rather than litigation of Title VII controversies. At the same time, such linkage of liability limitation to effective preventive and corrective measures could serve Title VII's deterrent purpose by encourag[ing] employees to report harassing conduct before it becomes severe or pervasive.<sup>36</sup>

These Supreme Court decisions demonstrate the anomaly between criminal and civil corporate liability standards. This anomaly is all the more striking given the supposed greater severity criminal sanctions are supposed to carry than civil ones. As the Supreme Court remarked in *Suders*, a harsher claim should be more difficult to prove than an easier one. In *Suders*, the Court rejected the Third Circuit's conclusion that the *Faragher-Ellerth* "reasonable care to prevent and correct promptly" defense was inapplicable where sexual harassment led to the constructive discharge of the employee, but was available when the harassment led to lesser consequences.<sup>37</sup> As *Suders* noted, "placement of the line [by the Third Circuit], anomalously, would make the *graver* claim of hostile-environment constructive discharge *easier* to prove than its lesser included component, hostile work environment."<sup>38</sup>

But as the law currently stands, an employer can more readily defend a civil claim than a criminal one. In civil harassment cases, vicarious liability is not automatic. In cases of co-worker harassment, negligence is required at the very least. And in cases of supervisory harassment where a threat of harassment has not been acted upon, an affirmative defense is available to the employer. No such limitations, however, apply in the criminal context where an employer is liable so long as the conduct was within the broad scope of the employee's duties and motivated at least in part by a desire to benefit the employer.<sup>39</sup>

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35. *Faragher*, 524 U.S. at 805-06; *see also Ellerth*, 524 U.S. at 764 ("Title VII is designed to encourage the creation of anti-harassment policies and effective grievance mechanisms. Were employer liability to depend in part on an employer's effort to create such procedures, it would affect Congress' intention to promote conciliation rather than litigation in the Title VII context. . . .").

36. *Suders*, 542 U.S. at 145 (citation omitted) (internal quotations omitted).

37. *Id.* at 148-49.

38. *Id.* at 149 (emphasis in original).

39. Under current criminal law doctrine, the actions of a coworker, no matter how low-level, can be imputed to the employer with no distinction between supervisory and non-supervisory personnel for purposes of application of vicarious liability. Moreover, although sexual harassment may often be undertaken exclusively to benefit the harasser and not the employer—and thus not meet the current criminal law requirement regarding motive—that is

The Court's willingness to limit the application of vicarious liability where it would lead to results at odds with the goals of the underlying law is most evident in *Kolstad v. American Dental Ass'n*.<sup>40</sup> In *Kolstad*, the Court limited vicarious liability agency principles to shield employers from liability for punitive damages under Title VII.

Carole Kolstad claimed that she had been passed over for promotion by her employer, the respondent, in favor of a "sham" selection process that was a pretext for sexual discrimination. The jury found in her favor, but the trial court, disagreeing with the verdict, held that she was not entitled to send the issue of punitive damages to the jury.<sup>41</sup>

Under the Civil Rights Act of 1991, punitive damages are limited to cases in which "the employer has engaged in intentional discrimination and has done so 'with malice or with reckless indifference to the federally protected rights of an aggrieved individual.'"<sup>42</sup> Thus, the Court determined that the statutory scheme made plain that Congress sought to impose two standards of liability: "[O]ne for establishing a right to compensatory damages and another, higher standard that a plaintiff must satisfy to qualify for a punitive award."<sup>43</sup>

In a holding initially favorable to the plaintiff, the Court held (7-2) that the statute did not require the employee to show that the employer in fact discriminated in an "egregious" or "outrageous" manner to recover punitive damages. The statute focused on the intent of the employer and did not additionally require that the employer's conduct be egregious, although the latter conduct could be proof of the requisite intent by the employer.<sup>44</sup> As for the requisite intent by the employer, the Court found that the statute focused not on the employer's intent to engage in the act of discrimination, but rather the employer's intent to engage in an act that it knows may violate federal law. "Applying this standard in the context of § 1981a, an employer must at least discriminate in the face of a perceived risk that its actions will violate federal law to be liable in punitive damages."<sup>45</sup>

The Court went further, however. Although not fully briefed by the parties, the

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not always the case. As the Supreme Court recognized in *Faragher* and *Ellerth*, harassment can be performed to benefit the company, even if the employee is misguided in that belief. See *Ellerth*, 524 U.S. at 756 (1998) (finding that discrimination by supervisor may be intended to benefit the employer); *Faragher*, 524 U.S. at 791, 794-95, 798-99 (1998).

40. 527 U.S. 526 (1999).

41. *Id.* at 530-32.

42. *Id.* at 529-30, 534 (citation omitted).

43. *Id.* at 534.

44. *Id.* at 534-35, 538-39.

45. *Kolstad v. Am. Dental Ass'n*, 527 U.S. 526, 536 (1999). Thus, not all intentional discrimination would result in eligibility for punitive damages. As noted by the Court, employers would not be subject to punitive damages where the employer is unaware of the relevant federal prohibition; where the underlying theory of discrimination is novel or otherwise poorly recognized; or where an employer reasonably believes that its discrimination satisfies a statutory exception to liability. *Id.* at 536-537.

Court determined (5-4)<sup>46</sup> that it would set forth the applicable law regarding when it was appropriate to impute knowledge to the employer for imposition of punitive damages. The Court noted various general principles of agency law that generally govern application of vicarious liability and then rejected their strict application to imposition of punitive damages. “In light of the perverse incentives that the Restatement’s ‘scope of employment’ rules create, we are compelled to modify these principles to avoid undermining the objectives underlying Title VII.”<sup>47</sup>

Its analysis is telling. The Court cited the Restatement (Second) of Agency, which provides:

Punitive damages can properly be awarded against a master or other principal because of an act by an agent if, but only if:

- (a) the principal authorized the doing and the manner of the act, or
- (b) the agent was unfit and the principal was reckless in employing him, or
- (c) the agent was employed in a managerial capacity and was acting in the scope of employment, or
- (d) the principal or a managerial agent of the principal ratified or approved the act.<sup>48</sup>

The Court noted that under this definition an employer could be subject to punitive damages even if the employer had acted in good faith and established policies to prevent discrimination. “On this view, even an employer who makes every effort to comply with Title VII would be held liable for the discriminatory acts of agents acting in a ‘managerial capacity.’”<sup>49</sup>

The Court was troubled by the fact that imposition of vicarious liability in such circumstances was at odds with the notion that punitive damages should apply only to those who are not personally innocent.<sup>50</sup> Moreover, application of agency vicarious liability would serve as a disincentive to employers to enact anti-discrimination policies. “Dissuading employers from implementing programs or policies to prevent discrimination in the workplace is directly contrary to the purposes underlying Title VII.”<sup>51</sup> The Court, citing both *Faragher* and *Ellerth*,

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46. The dissent did not oppose the majority’s determination on the merits. Instead, it objected to the Court deciding an issue that it did not view as properly raised. *See id.* at 547 (Stevens, J., dissenting). There is reason to believe that Justice Stevens, in light of his dissent in *Bennis*, would agree with the majority’s analysis. *See Bennis v. Michigan*, 516 U.S. 442, 458 (1996) (Stevens, J., dissenting).

47. *Kolstad*, 527 U.S. at 545 (1999).

48. *Id.* at 542-43 (quoting RESTATEMENT (SECOND) OF AGENCY § 217(c) (1957)).

49. *Id.* at 544. The Court noted the expansive definition of “scope of employment” under common law agency principles. Intentional torts are within the scope of an agent’s employment if the conduct is “‘the kind [of task the employee] is employed to perform,’ ‘occurs substantially within the authorized time and space limits,’ and ‘is actuated, at least in part, by a purpose to serve the’ employer.” *Id.* at 543-544 (quoting RESTATEMENT (SECOND) OF AGENCY, § 228(1)). If these prerequisites are met, an employer can be liable even if the employee engages in acts “‘specifically forbidden” by the employer and uses “‘forbidden means of accomplishing results.”” *Id.* at 544.

50. *Id.* at 544 (citing RESTATEMENT (SECOND) OF TORTS, § 909 cmt. b (1977)).

51. *Kolstad v. Am. Dental Ass’n*, 527 U.S. 526, 545 (1999).

reiterated that Title VII was not intended primarily to provide redress, but to prevent harm by encouraging the creation of anti-discrimination “policies and effective grievance mechanisms.”<sup>52</sup> Shielding employers who establish those procedures in good faith would “motivate” employers to “detect and deter Title VII violations.”<sup>53</sup> The Court applied this limiting principle even though the agency rules already limited imputation to “managerial” employees in two of its four categories.

As Justice Stevens has recognized, resort to a strict liability standard is not the best means to promote the deterrent value in the criminal law.<sup>54</sup> In *Bennis*, the state forfeited a car, jointly owned by husband and wife, which was used by the husband to solicit a prostitute. The Court analogized to civil tort law in allowing the state not to allocate to the wife a share of the forfeited proceeds, even though the wife had taken all reasonable precautions with respect to the use of the car. As Justice Stevens observed, the Court upheld the state action because it was more akin to a civil action than it was “punitive.” As the Court held in *Phile v. Ship Anna*:

The law never punishes any man criminally but for his own act, yet it frequently punishes him in his pocket, for the act of another. Thus, if a wife commits an offence, the husband is not liable to the penalties; but if she obtains the property of another by any means not felonious, he must make the payment and amends.<sup>55</sup>

*Kolstad* should bode ill for the continued vitality of the broad scope of criminal corporate liability for corporations. Even more so than the civil punitive damages at issue in *Kolstad*, criminal punitive sanctions should apply only to those who are personally guilty. And the goal of encouraging effective procedures to “detect and deter” violations applies at least as much to corporate policies aimed at criminal acts by employees as to discrimination by employees barred by civil statute. Yet, under current criminal corporate liability standards an employer would be liable for the conduct of even a low-level employee, in spite of management being unaware of such conduct, having acted in good faith, and having implemented extensive mechanisms to prevent such conduct. That same employer, however, would not be subject to punitive civil damages under *Kolstad*.<sup>56</sup>

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52. *Id.* at 545 (citing *Burlington Indus., Inc. v. Ellerth*, 524 U.S. 742, 764 (1998) & *Faragher v. City of Boca Raton*, 524 U.S. 775, 806 (1998)).

53. *Id.* at 546 (internal quotations omitted).

54. *See Bennis v. Michigan*, 516 U.S. 442, 469 (1996) (Stevens, J., dissenting) (“Even on a deterrence rationale, moreover, that goal is not fairly served in the case of a person who has taken all reasonable steps to prevent an illegal act.”).

55. 1 U.S. 197, 207 (1 Dall. 1787).

56. One potential oddity in *Kolstad* is the standard of intent required to find punitive damages. The standard articulated by the Court is akin to the willfulness standard in the criminal law which, unlike the “knowing and intentional” standard, often requires the government to prove that the defendant knew what she was doing was wrong or even against the law. *See Kolstad v. Am. Dental Ass’n.*, 527 U.S. 526, 549 (1999) (Stevens, J., dissenting). The punitive damage intent standard is thus higher than the intent required by many criminal statutes.

### C. *The Benefits of Limiting Criminal Corporate Liability*

A carefully constructed limitation of criminal corporate liability to those situations where a company reasonably should have taken steps to detect and deter the criminal action of its employee should inure to the benefit of the government, the public, and the corporation itself. The rationale for altering the law is strong. Corporate criminal law—indeed, law in general—is a creation of the state, and not immutable; thus we should seek the thinnest integument between the requirements of the law and outcomes that are just and rational.

The benefits would be palpable from a theory of criminal corporate liability that takes into account the actions of the corporation to prevent and remedy criminal conduct by corporate actors. Prosecutors cannot and should not be everywhere, monitoring the activities of all of corporate America, even if society viewed that as desirable.

A standard of corporate criminal liability that is tied to whether the company has taken all reasonable steps to prevent and detect crime by its employees would strongly incentivize meaningful and necessary self-regulation. A company that sought to avoid criminal prosecution would have strong reasons to implement an effective compliance program, both to deter criminal activity at the outset and to use as a shield in the event criminality nevertheless occurred. The utility of such a liability standard would be at least as great as that under the anti-discrimination statute at issue in *Faragher*, *Ellerth*, and *Suders*. As the Supreme Court recognized in addressing Title VII, a theory of liability that encourages responsible corporate compliance serves to foster the purpose of a statute intended primarily to prevent harm, and not to make plaintiffs financially whole. Criminal statutes, no less than Title VII, are not intended primarily to make victims whole financially. They are meant to punish wrongdoers and deter similar crime.

Far from furthering the goals of criminal law, the current system of strict corporate vicarious liability removes an important incentive for corporations to implement effective compliance programs. Such programs serve both to thwart crime and detect it if it occurs. Under the parameters of criminal corporate liability articulated in this article, an effective compliance program can act as a sword in preventing criminal conduct by employees as well as a shield against corporate criminal prosecution if such criminal conduct by an employee nevertheless occurs. Under the current legal regime, a corporation is given no benefit at all under the law for even the best internal compliance program if such crime nevertheless occurs.<sup>57</sup> A corporation operating under the current regime of course still has an incentive to create such a program since preventing, or at least diminishing, the

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57. Prosecutors may as a matter of *discretion* accord corporations credit for having an effective compliance program. However, having such a program is merely a factor under existing internal DOJ guidelines and its absence is not a prerequisite to prosecution. The weight to be given to this factor is left exclusively to the State to determine. See Thompson Memorandum, *supra* note 22, at II.A, VII.A.

incidence of employee crime still redounds to the company's benefit and lessens the risk of corporate prosecution. That incentive would be all the greater, however, where the establishment of an effective compliance program would serve to shield the company from criminal prosecution and the vagaries of individual criminal prosecutors.

The fear that companies will seek to implement mere "show" programs that will fool courts and regulators is unrealistic. A company that had an ineffective system, including a mere "paper" system that existed on the books of the company but was not effectively implemented, would not be entitled to the protection the law would offer. And any effort to pass off intentionally a fake program as a real one would risk the company obstructing justice.<sup>58</sup> Prosecutors and courts are called on now to assess the effectiveness of such compliance programs in connection with deferred criminal prosecutions, as well as in civil contexts including under anti-harassment programs. For a company to succeed at such a ruse, it would need to implement an inadequate program, pass it off as sufficient, not otherwise be subject to criminal liability because the pervasiveness of the criminal conduct at issue would undermine establishing the adequacy of any program, and fool prosecutors, the court, and jurors. Such a scenario is particularly fanciful since in white-collar investigations of corporations the mere whiff of a criminal investigation can be devastating to the company and its stock price. In any event, while one cannot say that some foolhardy individuals will not attempt such a daring deception, the ability of such a crime to occur does not warrant rejection of the new liability standard.<sup>59</sup>

Conversely, for corporations the new criminal liability standard will greatly increase the reasons for implementing an effective compliance system, because such a system could assist in rooting out fraud as well as serve as a potential shield

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58. See, e.g., 18 U.S.C. §§ 1001, 1503, 1519 (2000) (making it a crime to "cover up by any trick, scheme or device a material fact").

59. Professor Kimberly D. Krawiec correctly observes that the American legal system is moving away from a strict liability system toward a duty-based system. Kimberly D. Krawiec, *Corporate Decisionmaking: Organizational Misconduct: Beyond the Principal-Agent Model*, 32 FLA. ST. U. L. REV. 571, 572 (2005). Such a movement, however, has not yet affected the standard for criminal corporate liability, as is advocated herein. Professor Krawiec argues in general that companies may well seek under *Faragher* and *Ellerth* to have mere paper programs and that courts and agencies are not adept at evaluating compliance programs, which *may* not empirically serve to deter conduct. She thus advocates resorting generally to a strict compliance system. *Id.* at 577, 580, 588-89, 591-96, 614. She does not, however, address the increased incentive for corporations by a *criminal* standard of liability that takes into account an effective compliance program, or the fact that post-Enron, courts and prosecutors have routinely evaluated corporate compliance programs as part of corporate investigations and deferred prosecution agreements. Indeed, her article, while questioning generally the evidence of the efficacy of compliance programs, does not focus on the unique attributes of criminal law, including the different goals of the criminal law. Finally, her criticism that it is difficult to evaluate the effectiveness of a compliance program is a charge that can be made with respect to the modified strict liability standard proposed by Professor Krawiec. *Id.* at 578-79. In any event, even if correct in the civil context, in the setting of criminal corporate liability her thesis would not warrant imposition of strict liability for a company that had undertaken all reasonable measures, including a state-of-the-art compliance program, since the company would have taken all actions that could possibly be asked of it.

from the government.<sup>60</sup> This latter function is particularly important in the field of criminal corporate liability, where corporations, as a practical matter, cannot afford to take criminal cases to trial and routinely become arms of the prosecution. The new corporate criminal liability standard will not eliminate the government's awesome power to indict a corporation or eliminate all abuse of power. It will serve, however, to reduce it in situations where a corporation can demonstrate its establishment of an effective compliance system.<sup>61</sup>

### III. DEFINING AN EFFECTIVE COMPLIANCE PROGRAM

The Supreme Court provided little guidance in the civil arena for determining a reasonably effective compliance program in the Title VII context. The courts and the EEOC were left to fill in the details. In the criminal corporate liability arena, by contrast, there already exist various sources for determining what the parameters of an effective system should encompass. Ultimately, what in fact is a reasonably effective system will be left to a jury and judge, but the guidance noted below will assist the finders of fact in making the factual determination in light of prevailing norms. The guidance noted herein is illustrative and not intended to be exclusive. A company that assesses its criminal risk and sets up reasonable systems to address that risk should suffice to provide a safe harbor from criminal prosecution.

Since the collapse of Enron and the numerous corporate scandals that emanated from that singular event, a virtual cottage industry has grown up regarding effective corporate compliance measures. Specific guidance can be found in DOJ memoranda and the numerous deferred prosecution agreements reached by the DOJ and corporations as well as in the Sentencing Guidelines governing corporations. These sources provide guidance as to the measures that are appropriate for a company to take in order to adequately deter and detect criminal conduct by corporate employees. Moreover, both Congress and the DOJ could promulgate additional guidance, if necessary, just as the EEOC could implement such guidance to implement the Title VII anti-harassment compliance measures that were the subject of *Faragher*, *Ellerth*, and *Suders*.

#### A. *The DOJ's Internal Approach: The Thompson Memorandum*

First, the DOJ has issued guidance regarding attributes of an effective program. As the agency principally tasked with the enforcement of the federal criminal laws, its assessment deserves particular weight. In 2003, the DOJ issued revised

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60. Cf. Diana E. Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 87 IOWA L. REV. 697, 710-11 (2002) (then-chair of the U.S. Sentencing Commission noting that sentencing guidelines, by giving reduction in sentence to a corporation that has an effective compliance program, have encouraged companies to adopt effective compliance systems).

61. The unethical and insufficiently supervised prosecutor could ignore such evidence and threaten to charge the corporation, knowing that in all likelihood the company will not call her bluff. But the risk of such conduct would be reduced by the new criminal standard.

guidelines (the Thompson Memorandum) for its prosecutors as to the factors to be considered in connection with whether or not to bring a criminal case against a corporation.<sup>62</sup> The Thompson Memorandum, named after the then-Deputy Attorney General of the United States, enumerates a series of factors to be considered by federal prosecutors before instituting criminal action against a corporation.<sup>63</sup> These factors include the criminal history of the corporation, the likely collateral consequences of prosecution, the level and role of criminal conduct of the corporate employees, and the existence of an effective corporate compliance program.<sup>64</sup> The Thompson Memorandum places particular emphasis on analysis of the *concrete* steps taken by the corporation to cooperate. In short, it sought to put teeth in corporations' common refrain to the DOJ that they were committed to being "good corporate citizens."

Although the Thompson Memorandum lists an effective compliance program as only one factor to consider, as opposed to giving it conclusive weight,<sup>65</sup> the memorandum nevertheless provides a useful guide as to the criteria for an effective program, particularly since the government itself defines the parameters of a compliance program that satisfies the goals of the criminal justice system that it is tasked with enforcing.

The Thompson Memorandum makes clear that a corporate compliance program that is not effectively internalized by corporate personnel and made a part of the corporate culture will not be deemed effective. A paper tiger will not suffice. Thus, a corporation seeking leniency before the DOJ must demonstrate "the efficacy of the corporate governance mechanisms in place within a corporation, to ensure that

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62. The Thompson Memorandum was a retooling of the guidelines promulgated in 1999 by the DOJ. Thompson Memorandum, *supra* note 22. The prior set of guidelines listed eight factors for deciding whether to prosecute a corporation: (1) the nature and seriousness of the offense, (2) the pervasiveness of the wrongdoing, (3) the corporation's history of similar conduct, (4) any voluntary disclosure of wrongdoing and ensuing cooperation, (5) the existence and adequacy of a compliance program, (6) efforts at remediation, (7) the potential for collateral consequences that could harm innocent third parties, and (8) the availability of civil or regulatory remedies. Memorandum from Eric H. Holder, Jr., Deputy Att'y Gen., to All Component Heads and United States Attorneys, Bringing Criminal Charges Against Corporations at II. (June 16, 1999), available at <http://www.usdoj.gov/criminal/fraud/docs/reports/1999/chargingcorps.html>. The latest iteration of the Memorandum by Deputy Attorney General Paul McNulty in December 2006, does not alter in any material respects these criteria, for purposes of this Article. See Memorandum from Paul J. McNulty, Deputy Attorney General, to Heads of Department Components and U.S. Attorneys on Principles of Federal Prosecution of Business Organizations, at 16 (2006), available at [http://lawprofessors.typepad.com/whitecollarcrime\\_blog/files/mcnulty\\_memo.pdf](http://lawprofessors.typepad.com/whitecollarcrime_blog/files/mcnulty_memo.pdf).

63. Thompson Memorandum, *supra* note 22, at II.

64. *Id.*

65. *Id.* at VII.A ("However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct undertaken by its officers, directors, employees, or agents."). The Thompson Memorandum can be rightly criticized for not always recognizing the differences between corporate and individual liability. See *id.* at I.B, II ("Corporations are 'legal persons' . . . Generally, prosecutors should apply the same factors in determining whether to charge a corporation as they do with respect to individuals."). This standard fails to recognize that individuals can control their own conduct and are thus deemed responsible when they transgress the criminal laws. Corporations, by contrast, cannot control the actions of all their employees to the same extent that an individual can.

these measures are truly effective rather than mere paper programs.”<sup>66</sup> Under the DOJ guidelines, a compliance program must be “adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees.”<sup>67</sup> The program must then be effectively implemented because, according to the DOJ, prosecutors evaluating such programs should ask, “[d]oes the corporation’s compliance program work?”<sup>68</sup> Notably, the DOJ concedes that the mere fact that an employee commits a crime that is motivated in part to benefit the corporation is insufficient to conclude that a program is ineffective.<sup>69</sup>

In assessing a corporate compliance program, a prosecutor is to ask a series of sensible questions such as: do the company’s directors exercise independent and informed review over proposed actions; are there internal audit systems in place to ensure independent evaluation of corporate transactions; is there a reporting system within the company that provides management and the board of directors with timely and accurate information about the company’s compliance with the law; does the compliance program address detection of the types of misconduct “most likely” to occur in the company’s particular business; are employees adequately informed about the corporation’s compliance program and do they have faith that it reflects the values of the corporation and its management; and has the company adequately staffed the compliance program “sufficient[ly] to audit, document, analyze, and utilize the results of the corporation’s compliance efforts.”<sup>70</sup>

### B. *Deferred Prosecution Agreements*

In addition to these general precepts set forth by the DOJ in the Thompson Memorandum, there are other useful benchmarks to determine the attributes that the government believes are appropriate for an effective compliance program. These benchmarks can be found in the numerous deferred prosecution agreements entered into post-Enron between the DOJ and corporations seeking to avoid indictment. Moreover, since these measures are those that were required by the DOJ of companies that had been investigated criminally, they are a particularly useful source for determining the attributes of a program that would, by definition, satisfy criminal prosecutors.

These agreements put additional flesh on the bones regarding measures that can evidence that a corporation is “maximizing” its ability to “prevent and detect” crime.<sup>71</sup> For instance, in the first major corporate deferred prosecution agreement entered into by the government post-Enron, the DOJ and Merrill Lynch & Co., Inc. agreed to a series of specific compliance measures set forth in detail in the deferred

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66. *Id.* at preface.

67. *Id.* at VII.B.

68. *Id.* (internal quotation omitted).

69. Thompson Memorandum, *supra* note 22, at VII.B.

70. *Id.*

71. *Id.*

prosecution agreement.<sup>72</sup> Those measures included the establishment of a committee to review all proposed transactions in specific high-risk areas, defined to include year-end transactions and back-to-back transactions designed to offset in whole or in large measure, any risk.<sup>73</sup> The deferred prosecution agreement banned all transactions that the company knew or believed were intended “to achieve a misleading earnings, revenue or balance sheet effect.”<sup>74</sup> In addition, it banned all oral agreements, a measure that served to address the problem identified at Merrill Lynch of executives entering into or proposing oral agreements that would negate written agreements that were supposed to reflect the entire deal, and thus avoid scrutiny by inside or outside lawyers, accountants, and regulators.<sup>75</sup>

The agreement also empowered back-office compliance personnel by giving them absolute veto power over any transaction reviewed by the committee. This provision served to address the common phenomenon of executives in the profit centers of a firm ignoring personnel perceived as less significant to generating revenues.<sup>76</sup> The agreement also required Merrill Lynch to notify the outside

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72. Letter from Leslie R. Caldwell & Andrew Weissmann, Enron Task Force, Dep’t of Justice to Robert S. Morvillo, Counsel to Merrill Lynch & Co. ¶¶ 8-9, ex. A (Sept. 17, 2003) [hereinafter Merrill Lynch Letter], available at <http://www.corporatecrimereporter.com/documents/merill2003.pdf>. The format of the agreement consists of a set of “Policies and Procedures” set forth as an addendum to the agreement; implementation of those measures is made a condition of the corporation’s compliance with the agreement. *Id.* ¶ 8. Subsequent DOJ agreements follow a similar format. See, e.g., CIBC Letter, *supra* note 33, ¶ 9, app. B. Other agreements empower the monitor to evaluate the firm’s compliance system and make appropriate alterations. See, e.g., Deferred Prosecution Agreement, United States v. Am. Online, Inc., No. 1:04 M 1133, ¶ 13 (E.D. Va. Dec. 15, 2004), available at <http://www.corporatecrimereporter.com/documents/aol.pdf>.

73. See Kurt Eichenwald, *Merrill Reaches Deal with U.S. in Enron Affair*, N.Y. TIMES, Sept. 18, 2003, at A1 (outlining the government’s deal with Merrill Lynch); Merrill Lynch Letter, *supra* note 72, ex. A. A similar requirement was imposed with respect to CIBC. See CIBC Letter, *supra* note 31, app. B, ¶ 5. The agreement with Symbol Technologies, Inc., established a new “disclosure” committee to review filings with the SEC. See Symbol Agreement, *supra* note 31, ¶ 9(e); Deferred Prosecution Agreement, United States v. N.Y. Racing Ass’n, Inc., No. 03-1295, ¶¶ 5(g), 6 (Dec. 11, 2003) [hereinafter NYRA DPA], available at <http://www.corporatecrimereporter.com/documents/nyra.pdf> (creating new “Special Oversight Board” and two new chief operating officer positions). Subsequent deferred prosecution agreements also contain various record-keeping requirements so as to be able to document to auditors and regulators that the compliance program is working. See, e.g., CIBC Letter, *supra* note 31, app. B, ¶ 5 (requiring written communication to the outside auditor); KPMG Letter, *supra* note 31, ¶ 6(i)(VI) (requiring KPMG facilitate the monitor’s review).

74. Merrill Lynch Letter, *supra* note 72, ex. A; see also CIBC Letter, *supra* note 31, app. B, ¶ 2.

75. Merrill Lynch Letter, *supra* note 72, ex. A. A similar requirement was imposed with respect to CIBC. CIBC Letter, *supra* note 33, app. B, ¶ 2(a). An oral side deal was at the heart of the illegal transaction between Merrill Lynch and Enron that was charged by the government. Four Merrill Lynch executives were indicted for participating in a parking transaction, which allowed Enron to book sufficient earnings for 1999 to meet Wall Street analyst expectations. In reality, an oral side deal pursuant to which Enron guaranteed Merrill Lynch a return on its “investment” negated the transaction being a true sale. See United States v. Bayly, No. 05-23019 (S.D. Tex. 2003) (Indictment setting forth alleged illegal oral side deal). An oral side deal was also at the heart of the illegal deals between CIBC and Enron that served to inflate artificially Enron’s reported earnings. See CIBC Letter, *supra* note 31, app. A ¶ 6 (describing oral agreement by Enron to guarantee CIBC’s supposed equity investment in Enron vehicle, which negated the investment being sufficiently at risk to constitute “equity”).

76. Merrill Lynch Letter, *supra* note 72, ex. A; see also CIBC Letter, *supra* note 31, app. B, ¶ 5. In another innovation intended to decentralize power, the deferred prosecution agreement with Symbol Technologies

auditor of its client of the proposed terms of a contemplated transaction. This measure served to assure that all participants in the proposed transaction had the same understanding of the deal terms and were not being given misinformation so as to gain approval by accountants and lawyers—the purported gatekeepers and watchdogs.<sup>77</sup> Finally, the agreement mandated a series of training, anonymous reporting, and anti-retaliation provisions to assure that the new procedures were effectively communicated to employees and integrated into the firm.<sup>78</sup>

#### CONCLUSION

In the wake of Enron's demise and the subsequent series of corporate scandals, Congress and the U.S. Sentencing Commission acted quickly to pass innovative and stiff laws and guidelines to deter white-collar crime by individuals and corporations. The DOJ also aggressively pursued not just individual white-collar criminals, but corporations as well, using the new-found tools at its disposal. The confluence of justified public outrage at unchecked greed by corporate crooks, new sweeping legal tools, and aggressive prosecutions has had many societal advantages. But this recent increased scrutiny of corporate malfeasance has also served to bring to light a fissure in the current legal system. Corporate criminal liability has been stretched past the breaking point where it no longer serves the purposes of the criminal laws. It is time for further reform; this time giving renewed clarity and focus to the goals of criminal corporate liability and the prosecutor's role in pursuing corporate fraud. Far from giving corporations a shield to commit fraud, a system that ties criminal liability to the lack of an effective compliance program will do what the practical limitations on a prosecutor's time and resources could never permit: create greater incentives for boardrooms around the country to devise, implement, and monitor compliance measures. Conversely, by placing the burden on the government to prove that a company's program was inadequate as a prerequisite to criminal corporate liability, this reform will provide a systemic check on prosecutors who seek to institute such actions in the future, helping to ensure that they do so only where the company should be justifiably responsible

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required that the Chairman and CEO functions be split between two people. Symbol Agreement, *supra* note 31, ¶ 9(f).

77. Merrill Lynch Letter, *supra* note 72, ex. A; *see also* CIBC Letter, *supra* note 31, app. B, ¶ 5. In the parking transaction between Merrill Lynch and Enron, trial evidence demonstrated that Enron had lied to its own outside auditors about the terms of the deal. The provision in the DOJ agreement sought to lessen the ability of a company to portray a transaction differently depending on the audience being addressed. By breaking down the heretofore sacrosanct wall between the parties to a deal and their respective outside auditors, the ability to pull off such prevarication was viewed as diminished since it greatly expanded the number of institutions, with varying interests, who would have to go along with the deception. A similar requirement was imposed with respect to CIBC.

78. Merrill Lynch Letter, *supra* note 72, ex. A (setting forth requirements for, inter alia, training, confidential reporting, establishment of a hotline, and anti-retaliation provision); *see also* CIBC Letter, *supra* note 31, app. B ¶¶ 6, 9-12; NYRA DPA, *supra* note 73, ¶¶ 5(g); Symbol Agreement, *supra* note 31, ¶¶ 9(i) & 10; KPMG Letter, *supra* note 31, ¶¶ 16, 18(e)(III).

for the criminal conduct of its employees. The precepts that ground this article's proposal have been endorsed by the Supreme Court in civil cases and have proved workable. The incorporation of these civil corporate liability parameters into the criminal context is both warranted and overdue.