

REMOVING PROSECUTORS FROM THE BOARDROOM:
LIMITING PROSECUTORIAL DISCRETION TO IMPOSE STRUCTURAL REFORMS
Jennifer Arlen*

Prosecutors in the United States are no longer content to simply sanction corporations for their employees' crimes. They now regularly intervene in corporations' internal affairs by pressuring firms to adopt structural reforms ostensibly designed to reduce the likelihood of future wrongdoing. Moreover, prosecutors do not restrict their structural reform mandates to corporations convicted of federal crimes. They also use deferred prosecution agreements (DPAs) and nonprosecution agreements (NPAs) to pressure firms that are merely *potentially* subject to conviction to agree to structural reforms in order to avoid indictment or conviction. Through these DPAs and NPAs, prosecutors have required firms to adopt prosecutor-approved compliance programs, alter the structure of the board of directors, accept and pay for an outsider monitor, and, in some cases, change their business practices.

Prosecutors' use of DPAs and NPAs to intervene in the internal affairs of nonprosecuted corporations represents a change in strategy. The Department of Justice (DOJ) developed its non-prosecution policy to help federal authorities detect and sanction individuals responsible for corporate crime. To accomplish this goal, the DOJ abandoned its adherence to traditional vicarious criminal liability and adopted a policy governing corporate indictment and conviction designed to encourage corporations (and their directors)¹ to report detected wrongdoing, identify individual wrongdoers, and cooperate with federal prosecutions of individual wrongdoers. To encourage reporting and cooperation, the DOJ offers to exempt from prosecution firms that report wrongdoing and cooperate with prosecutors, while threatening firms that do not do so with enormous criminal sanctions.²

Traditionally, prosecutors took a relatively hands-off approach to firms eligible for nonprosecution. The boards of directors of these firms were free to decide how best to deter and detect wrongdoing in the future. This is no longer the case. Today, prosecutors regularly inject themselves into the internal affairs of firms eligible for non-prosecution by requiring them to accept prosecutor-approved compliance programs, corporate monitors, and other corporate governance reforms in return for prosecutors' agreement not to indict or prosecute them. In so doing, prosecutors substitute their own judgment about what internal corporate governance reforms are needed for the judgment of both the firm's board of directors and civil federal regulators.

Federal prosecutors' propensity to require publicly held firms to agree to structural reforms as a condition of nonprosecution raises two important questions. The first is: should federal authorities ever impose structural reforms on publicly held firms? The second is: when direct federal oversight is needed, should this oversight be exercised by prosecutors, or should it instead be the exclusive purview of federal civil regulatory authorities whenever possible? This Chapter is concerned with the latter question.

This Chapter contends that prosecutors should not impose structural reforms on nonindicted corporations. Instead, civil regulatory authorities should exercise sole authority over mandated corporate governance reforms, in those situations where it is appropriate for federal authorities to require firms to accept structural reforms (including outside monitors). Prosecutors generally should not use DPAs and NPAs to induce firms to adopt structural reforms, such as compliance programs, because compliance program design involves difficult judgments about when and where to centralize decision-making and to collect and channel information. Industries and firms vary enormously as to whether, and in what areas, the compliance benefits of decision-making centralization and oversight exceed the costs. Prosecutors rarely have sufficient experience working in any business, much less adequate industry-specific expertise, to make these decisions reliably. By contrast, civil federal regulatory authorities are more likely to have this expertise, at least with respect to the industries they regulate. In addition, prosecutors are subject to little, if any, external oversight when they intervene in internal corporate affairs. Moreover, prosecutors' offices do not have a formal process for assembling and evaluating data on different compliance programs and monitoring plans to assess their effectiveness. By contrast, regulatory agencies are subject to greater oversight; moreover, they have the information-gathering abilities needed to assess compliance decisions. Agencies' ability to gather information and collect public comments reduces the risk that federal authorities will mandate expensive, but ultimately ineffective, measures. Finally, regulatory agencies are in a position to conduct more widespread, industry-specific, and formal assessments of compliance to determine if any firm-specific mandated reforms should be adopted on a more widespread basis. Delegating authority over governance reforms and corporate monitoring to civil authorities would enable the federal government to use corporate liability to induce firms to adopt effective compliance programs while reducing the risk that federal authorities will intervene in corporate affairs without sufficient expertise or incentives to do so effectively.

This Chapter proceeds as follows. Section I describes the unusual structure of U.S. practice governing corporate liability and presents reasons to question the wisdom of granting prosecutors authority to regulate corporate governance. Section II presents our traditional approach to corporate criminal liability, and demonstrates why the DOJ had to abandon it in order to adequately deter crime. Section III describes how corporate criminal liability evolved to embrace a proactive policy of using non-prosecution to induce corporations to deter crime. Section IV shows that the central goals of these reforms can be achieved, at lower cost, if prosecutors refrain from using NPAs and DPAs to interfere in firms' internal operations. Whenever possible, they should leave full authority over a firm's internal affairs to its board of directors or, where intervention is necessary, civil regulatory authorities.

I. U.S. PROSECUTORS' UNUSUAL POWER TO INDUCE STRUCTURAL REFORMS

U.S. prosecutors have considerable ability to pressure firms whose employees apparently have committed a crime to adopt structural reforms ostensibly designed to reduce the likelihood of future wrongdoing. This unusual power is the result of four unique features of U.S. law that combine to give prosecutors both the leverage needed to induce corporations to comply with their wishes and the incentive to use that influence. Yet whereas prosecutors once used this influence to induce corporate boards to adopt compliance programs and cooperate, prosecutors now use their authority to intervene directly in internal corporate affairs, both by mandating structural reforms and requiring corporate monitoring. This expansion of prosecutorial power raises concerns.

A. Corporate Criminal Enforcement in the U.S.

Federal prosecutors are able to induce corporations subject to investigation to comply with their wishes because U.S. corporate criminal liability is unusually expansive and costly.

The U.S. has a wide range of criminal laws governing corporate activities, including laws imposing criminal liability for not acting to deter crimes by others. Moreover, the scope of U.S. corporate criminal liability is especially broad. Corporations are potentially criminally liable for all crimes committed by employees acting in the scope of employment, with some intent to benefit the firm.³ A firm can be criminally liable even if the wrongful employee was relatively low level. Indeed, the firm can be held criminally liable even if senior managers told employees not to commit any crimes and adopted measures intended to deter them.⁴ Accordingly, a corporation has few (if any) defenses once a prosecutor can show that any of its employees committed a crime in the course of employment.⁵

In addition, corporations convicted of a federal crime are subject to unusually high monetary and non-monetary penalties. Criminal fines and other associated sanctions can reach into the hundreds of millions of dollars. Enormous government civil penalties often are imposed as well.⁶ Beyond this, U.S. Sentencing Guidelines grant prosecutors broad authority to impose non-monetary sanctions on corporations. These sanctions range from sanctions that can be quite damaging but are minimally intrusive—such as a mandate that the corporation publicize the fact that it committed a crime—to those that intrude on internal corporate operations, such as federally-mandated compliance programs. Finally, many firms convicted of a federal crime are potentially subject to ruinous collateral sanctions, such as an inability to do business with the federal government. For some firms, such as accounting firms, the collateral consequences of a conviction may be fatal.

These distinct features of U.S. corporate criminal law combine to enable prosecutors to impose substantial and intrusive sanctions on firms convicted of a federal crime. The next two features enable and encourage prosecutors to extend their influence to firms that are merely *potentially* subject to criminal conviction. First, U.S. law is unusual in its commitment to the view that the government can

best deter corporate crime by both imposing criminal liability on individual wrongdoers and using the *threat* of corporate criminal liability to induce corporations to help federal authorities detect crimes and prosecute individual wrongdoers. This instrumental approach to corporate criminal liability has led to the fourth and most distinctive feature of U.S. corporate criminal liability: the formalized divide between the rules governing when corporations *can be* held criminally liable and the formal standards governing when federal prosecutors actually *do* subject corporations (especially publicly held firms) to criminal liability for employee wrongdoing. This divide does not arise from a law enacted by Congress. Instead, it results from a formalized exercise of discretion by the DOJ.

Beginning in 1999, the Deputy Attorney General issued guidelines directing federal prosecutors to refrain from indicting corporations for their employees' crimes when the corporation engaged in specified acts of good conduct, such as maintaining an effective program to induce compliance with criminal laws, promptly reporting detected wrongdoing, and fully cooperating with federal authorities in order to bring individual wrongdoers to justice.⁷ These guidelines transformed the broad *de jure* rule of strict corporate criminal liability into a *de facto* rule under which a corporation could avoid criminal prosecution by adhering to specific enforcement duties.

Initially prosecutors employed this formalized discretion to induce firms both to detect and report wrongdoing and to cooperate with federal investigations, in order to help the government to identify and convict the individuals responsible for crimes. Firms that satisfied their duties often avoided both conviction and indictment, paying only monetary civil penalties. Over time, however, prosecutors changed their approach and started intervening more directly in the internal affairs of corporations potentially subject to indictment. Specifically, prosecutors started using their power to impose ruinous criminal liability on corporations, in concert with their authority not to prosecute, to pressure firms to agree to adopt structural reforms in return for not being prosecuted (or even indicted), in addition to paying monetary penalties.⁸

Some of these structural-reform-imposing DPAs and NPAs do little more than require firms to adopt compliance programs that the firms would have adopted anyway. But others go far beyond this, requiring firms to adopt corporate governance reforms and intrusive compliance programs that they would not have adopted on their own.⁹ Indeed, some DPAs and NPAs require firms to eliminate certain business areas.¹⁰ Others require firms to accept (and pay for) an outside monitor who may be granted substantial authority to monitor and interfere in the firm's internal operations.¹¹ These mandates can persist for many years.

B. Some Reasons for Concern

These structural reform DPAs and NPAs represent a change in prosecutors' practice. Previously, prosecutors tended to use the threat of financial sanctions and ability to offer leniency to provide corporations with *incentives* to prevent crime, report it, and help prosecutors sanction individual wrongdoers. Prosecutors generally allowed unconvicted publicly held firms to decide how best

to deter crime. By contrast, prosecutors imposing structural reform DPAs and NPAs assert authority to design and oversee the internal operations of firms that have not been convicted of a crime, both directly through mandated structural reforms and indirectly through the use of monitors who report to prosecutors. Prosecutors' assertion of broad, largely unfettered discretion to impose substantial structural governance changes and to use monitors to oversee internal operations appears to be largely unique to the corporate crime area. It raises many concerns.¹²

The most basic concern is that prosecutors may abuse this discretion because they are not subject to any significant outside oversight. This concern was heightened by the Bristol-Myers Squibb DPA that required the firm to spend \$5 million to endow a business ethics chair at Seton Hall Law School—the alma mater of Christopher Christie, the U.S. Attorney supervising the case.¹³ While the DOJ has taken steps to address known abuses such as this,¹⁴ prosecutors' ability to impose a wide range of non-monetary sanctions opens the door to other similar abuses because such sanctions can be hard for courts to scrutinize.

But there also is a more serious concern: that prosecutors, even when acting in good faith, may impose reforms on corporations that are both excessively costly and ineffective. Prosecutors, in mandating internal governance reforms and asserting authority to impose corporate monitors, are stepping outside their areas of greatest expertise—the detection, investigation, and prosecution of crimes—and venturing into internal corporate governance reform, a subject in which few of them have any deep experience.

Prosecutors who take the task of structural reform seriously¹⁵ necessarily inject themselves directly into corporate governance when they either dictate the structure of corporate compliance or require a firm to accept an effective corporate monitor. Compliance program design and oversight is a complicated task because it involves trade-offs between structures that help deter crimes and those that promote effective business. Crime often can be most effectively deterred and detected when corporate decision-making is top-down, information about corporate affairs is collected in a central location, and senior management is subject to genuine scrutiny. Yet this structure may not be best for business. Businesses often are best able to generate new initiatives and respond quickly to changes in the market when they grant discretion to relatively lower level managers and employees. Similarly, efforts to centralize information require firms to pay more attention to record-keeping, which may slow and bureaucratize decision-making. While effective in many situations, such efforts may be excessively expensive and time-consuming in others. Other prosecutor-mandated decisions—such as requirements that the CEO not also be the chairman of the board—involve equally fundamental decisions affecting how the firm should be governed. Monitors have an even greater potential to alter internal corporate structure, particularly when they are granted and assert broad authority to oversee, and make recommendations about, corporate practices. Thus, prosecutors cannot require structural reforms without altering a firm's internal operations in ways that may make it a less effective business.

This raises two important issues. The first is whether federal authorities should ever impose structural reforms, particularly on publicly held firms, as opposed to using the threat of corporate financial sanctions to induce directors to take the actions they believe will most cost-effectively deter crime.¹⁶ The second is whether prosecutors are the best authority to impose structural reforms, or whether this authority should be exercised by civil regulatory authorities, whenever possible. This Chapter focuses on this second issue.

The resolution of this issue depends on whether federal prosecutors can properly serve the central goals of corporate criminal liability while granting civil regulators sole authority over whether to impose structural reforms, wherever possible. To answer this question, we first need to understand the central goals of corporate criminal liability. To do this, we must understand why federal criminal enforcement authorities abandoned the traditional system and adopted formal guidelines governing non-prosecution.

II. THE TRADITIONAL APPROACH AND ITS LIMITATIONS

The DOJ did not always encourage prosecutors to refrain from indicting firms whose employees clearly had committed criminal violations—quite the contrary. At one point, prosecutors targeted corporations. Yet this more aggressive approach to corporate prosecution was not effective at inducing firms to take the most basic actions needed to deter corporate crime.

A. *The Traditional Approach*

Prior to the 1990s, corporations whose employees committed crimes were considered criminals, properly subject to corporate criminal liability for crimes committed by employees in the scope of employment through the doctrine of *respondeat superior*. *Respondeat superior* not only governed when prosecutors *could* indict a firm, it often determined when prosecutors *would* indict. Indeed, many prosecutors focused their enforcement efforts on obtaining corporate convictions, often without convicting the individuals who caused the crime.¹⁷

Although corporate criminal liability was very broad, corporate criminal sanctions were relatively weak. Prior to the mid-1980s, convicted corporations were subject to the same fines as individuals. These fines, which were established with individuals in mind, were quite low relative to both the harm caused by corporate crime and most firms' ability to pay. Indeed, sixty percent of federal corporate convictions resulted in the firm being fined \$10,000; the average fine was only \$45,790.¹⁸

Criminal penalties not only were lower than they are today, they also were less intrusive. Convicted corporations generally only faced financial penalties. Prosecutors generally did not impose even relatively mild non-monetary penalties, such as probation, and rarely used criminal liability to affect internal corporate governance, for example, by dictating the structure of corporate compliance efforts. Finally, unindicted corporations were not subject to substantial penalties,

and prosecutors did not require corporations to adopt substantial internal reforms in return for agreeing not to prosecute.¹⁹

B. Deterrence Function of Corporate Criminal Liability and the Need for Reform

In the 1990s, federal authorities abandoned the traditional approach to corporate criminal liability because it could not achieve its primary goal—detering corporate crime—particularly as applied to crimes arising from publicly held corporations. To deter corporate crime, the government must ensure that the individuals tempted to commit crimes expect to be punished. Traditional corporate criminal liability did not achieve this goal because it both targeted liability on the wrong place—on corporations rather than individuals—and deterred corporations from helping the government detect and prosecute crime.

1. Importance of Individual Liability for Publicly Held Firms' Crimes

The traditional focus on corporate liability was well-suited to the crimes that prosecutors tended to focus on at the time: crimes by closely held firms.²⁰ Closely held firm crimes often are committed by, or with the indirect encouragement of, the firms' owners/managers. Strict *respondeat superior* corporate criminal liability thus can serve as an effective deterrent by ensuring that owners pay for the firm's crime even when prosecutors cannot establish their complicity directly.

Strict corporate vicarious criminal liability is not effective when applied to crimes committed by publicly held firms, however. A publicly held firm's crimes generally are committed by managers or other employees, not by shareholders. Moreover, the individual wrongdoers usually commit such crimes for their own personal benefit—often job retention or promotion—and not to benefit equity. The wrongdoers often have relatively low equity stakes. Moreover, they often are willing to commit crimes even when the crime hurts shareholders.²¹

The recognition that publicly held firm corporate crime is committed by managers and other employees at their own direction to serve their own interests leads naturally to two conclusions. First, criminal law cannot deter such crimes unless it targets liability at individual wrongdoers and ensures that crime does not pay. Second, criminal law generally should not seek to punish publicly held firm shareholders for corporate crimes. Instead, corporate criminal liability should be used to ensure that corporations—thus, indirectly, directors—have strong incentives to deter crime.²²

2. Goals of Corporate Criminal Liability

Federal authorities cannot effectively deter corporate crime unless corporate criminal liability provides firms with an incentive to aid the government's enforcement efforts because, absent such assistance, federal authorities often will be unable either to detect corporate crimes or identify and sanction those responsible. Given the complex, far-reaching, and often decentralized nature of the modern publicly held firm, corporate crimes usually are hard to detect. They can remain hidden for years, even forever.²³ Moreover,

even when the government does detect wrongdoing, it may be unable to identify and punish the individuals responsible because corporate crimes often involve actions by many people, and often the person who committed the physical act that constitutes the crime is not the person who made the decision to commit it. As a result, many perpetrators of corporate crime could reap large rewards safe in the knowledge that the government would not be able to convict them. Accordingly, to deter crime effectively, the government needs corporations' assistance.²⁴

Corporations can be powerful allies in the war against corporate crime, if they so choose. First, they can reduce employees' incentives to commit crime—for example, by structuring their compensation and promotion policies to ensure that employees faced with poor short-run results do not feel compelled to seek illegal profits in order to save their jobs.²⁵ Firms also can deter crime by creating a “corporate culture” that promotes legal compliance.²⁶

In addition, corporations can deter crime by helping the government detect and prosecute wrongdoing. They can do this in three ways: by adopting compliance programs to monitor internal activities, reporting suspected wrongdoing, and cooperating with federal authorities' investigations (hereinafter, “policing”).²⁷ Corporate monitoring is important because corporations can detect internal wrongs more easily than can the government. Firms know their own operations and how particular activities should be done. Thus, they can better spot suspicious activities. Corporate cooperation also is important because corporations generally are in a better position to identify which individuals ultimately are responsible for the crime.²⁸

Corporate liability is needed because corporations will not spend money to deter crime unless the government provides them with strong financial incentives to do so.²⁹ Corporations will not undertake these actions unless threatened with liability because they otherwise would not have sufficient incentive to deter their employees' crimes. Market forces alone are not sufficient because, absent liability, corporations and their managers rarely are injured by these crimes.³⁰ Indeed, market forces may deter firms from detecting, reporting, or aiding in the prosecution of crimes that would undermine the firm's reputation with customers, suppliers, creditors, or shareholders, in order to avoid the resulting reputational market penalty.³¹

Corporate criminal liability is one of the tools the government can use to induce corporations to engage in prevention and policing. The government can use a combination of criminal and civil corporate liability to induce firms both to prevent wrongs and to aid the government's enforcement efforts by monitoring, reporting, and cooperating. Unfortunately, the traditional approach to corporate liability, which combined strict *respondeat superior* liability with low criminal sanctions, did not achieve either goal.

3. Problems with the Traditional Approach

The traditional strict *respondeat superior* corporate criminal liability failed to achieve its central goal—deterrence—because it discouraged firms from engaging in policing activities: monitoring, reporting, and cooperation. A

corporation will spend money on policing—notwithstanding the threat of any financial penalties (government-imposed, private damage actions, and/or reputational)—if criminal liability is structured to ensure that firms which do not monitor, report, or cooperate fare worse than those who do. Traditional strict *respondeat superior* corporate criminal liability created the opposite incentive structure. It discouraged firms from policing because under this rule a corporation that works to bring individual wrongdoers to justice also increased its own expected criminal liability for its employees' crimes. A firm that adopted an effective compliance program to detect wrongdoing thereby increased the risk that the evidence it created would be used to convict it if a crime occurred. A firm that reported wrongdoing could not do so without increasing its risk of being found criminally liable. By contrast, a company that turned a blind eye to the risk of crime, or even evidence of crime, might avoid sanction altogether. In addition, if the wrong was detected, the firm would not be subject to any formal increased sanction for not reporting or cooperating.³²

Thus, far from encouraging monitoring, reporting, and cooperation, traditional corporate liability actually discouraged it. Moreover, this rule created the greatest incentives not to police in the very situation where policing was most needed: when the government could not detect the crime without the corporation's assistance. Accordingly, it should come as no surprise that, under the traditional regime, publicly held corporations did not generally rush to adopt effective compliance programs or to report crimes and cooperate with federal authorities.³³

The traditional approach also failed to provide corporations with adequate incentives to prevent crimes directly—such as by changing compensation and promotion policies—because traditional corporate criminal sanctions were too low to provide firms an adequate incentive to refrain from profitable business practices that increased the risk of crime.³⁴ Moreover, given the lack of corporate monitoring and cooperation, publicly held firms faced a relatively low risk that wrongs would be detected or successfully prosecuted.

III. EVOLUTION OF FEDERAL CORPORATE CRIMINAL LIABILITY

Beginning in the mid-1980s, federal authorities adopted a series of reforms designed, in significant part, to improve the deterrence function of corporate criminal liability. These reforms 1) increased corporate criminal sanctions; 2) increased prosecutorial authority to impose non-fine criminal sanctions, including government-imposed compliance programs, on firms *convicted* of a crime; 3) transformed the traditional *de jure* regime of strict corporate criminal liability into a *de facto* regime in which corporations face criminal liability only if they neglect all their policing duties; and 4) encouraged prosecutors to target their enforcement efforts at convicting wrongful individuals. This initial slate of reforms dramatically transformed corporate liability, yet left prosecutors in their traditional role: free to use the threat of financial sanctions and their discretion to award leniency to deter wrongdoing. Then prosecutors

took these reforms a step further, using DPAs and NPAs to impose structural reforms on non-indicted corporations.

A. Increased Monetary Sanctions

In the mid-1980s, Congress took the first step towards reform when it adopted statutes specifically governing the fines to be imposed on corporations, thereby dramatically increasing the sanctions imposed on corporations convicted of federal crimes. To further enhance corporate sentences, Congress later empowered the United States Sentencing Commission to promulgate sentencing guidelines governing the sentencing of organizations. In 1991, the Sentencing Commission adopted the United States Sentencing Commission Guidelines for Organizations, with the explicit intent of increasing criminal fines imposed on corporations. The Guidelines also substantially increased the use of criminal non-fine monetary sanctions, such as criminal restitution and remediation.³⁵

These measures achieved their goal. Average criminal fines imposed on publicly held corporations after the Guidelines were ten times higher than previously. Whereas in the four years prior to the Guidelines, the average fine imposed on a convicted publicly held firm was \$1.9 million, in the five years after the Guidelines, a publicly held firm convicted of a federal crime was subject to an average fine of \$19 million in cases constrained by the Guidelines (in 1996 dollars).³⁶ Median fines increased from \$633 thousand to \$3.1 million in cases where the judge was legally bound to follow the Guidelines. Average total sanctions imposed on convicted publicly held firms—including criminal fines, non-fine criminal monetary sanctions, government civil penalties, and private civil sanctions—increased from \$13.3 million³⁷ to more than \$49 million (1996 dollars).³⁸

B. Expanded Non-Monetary Sanctions: Compliance as a Punishment

The Guidelines also expanded the non-fine interventions imposed on corporations convicted of a federal crime, by both requiring courts to impose probation in more circumstances than previously and expanding the range of sanctions that would be imposed pursuant to a probation order.³⁹

In its narrowest form, probation simply prohibits the firm from committing another criminal violation, of any sort, for a particular period of time. Yet even this form of probation has potentially serious consequences because it substantially increases the cost to the firm of any future violation. Any future crime would subject the firm to criminal penalties directly as well as to additional penalties for the original crime (since the subsequent crime would violate the probation order). Beyond this, the Guidelines also encourage prosecutors to use probation as a vehicle for imposing additional non-monetary sanctions on a firm, such as requiring the firm to implement a monitoring program, submit to inspections, publicize its conviction, or undertake community service. Indeed, the Guidelines mandate the imposition of court-mandated compliance programs in certain circumstances. The Guidelines also permit courts to take a variety of

actions to reduce the probability of future wrongdoing, including prohibiting the corporation from engaging in specific business practices.⁴⁰

C. Broad Individual Liability; Duty-based Corporate Criminal Liability

During the 1990s, federal authorities also changed their approach to the proper roles of both individual and corporate criminal liability for corporate crimes. Prosecutors came to recognize that individual liability should be the cornerstone of the government's effort to deter crime and focused more attention on obtaining individual convictions. Eventually, they became more willing to send publicly-held firm executives to jail for white collar crimes.

This move towards enhanced individual liability was accompanied by a transformation of corporate criminal liability. During the 1990s, the U.S. moved away from strict *respondeat superior* liability towards a more "duty-based" corporate criminal liability regime in which corporations could reduce, or eliminate, criminal liability by engaging in effective policing, such as adopting effective compliance programs, self-reporting, and cooperating with federal authorities. The transformation in the structure of corporate criminal liability took place in stages.

The 1991 Organizational Sentencing Guidelines took the first step away from strict *respondeat superior* liability by mandating a lower minimum and maximum fine for any convicted corporation with an effective compliance program. The Guidelines require additional mitigation if the firm reported the wrong within a reasonable time and/or cooperated fully with federal authorities. The Guidelines also provide that corporations taking these steps could avoid being subject to criminal probation, with the attendant threat of ongoing government involvement in the corporations' affairs.⁴¹

The Guidelines are an improvement over the prior system. But they do not offer sufficient reward for reporting and cooperation to induce firms to adopt effective policing. The central problem is simple: the Guidelines *reduce* the criminal sanction imposed on firms that monitor, self-report, and cooperate, but nevertheless leave them subject to criminal liability. This discourages firms from reporting suspected wrongdoing and cooperating because many would suffer enormous negative consequences from any federal conviction, as a result of collateral penalties, civil damages actions, and, in some situations, enhanced reputational penalties.⁴²

Recognizing this problem, the DOJ intervened to alter the de facto application of corporate criminal liability by offering to insulate firms which engage in effective policing from the threat of criminal liability. In order to ensure that firms retain incentives to prevent wrongs even when they expect to avoid criminal sanctions, federal authorities continued to impose civil penalties on firms potentially subject to criminal liability.⁴³

Specifically, starting in 1999, then-Deputy Attorney General Eric Holder issued federal prosecutors a set of guidelines detailing factors for them to consider in deciding whether to prosecute a corporation whose employees committed a crime.⁴⁴ Of particular importance, the Holder Memo stated that, in deciding

whether to exempt a corporation from prosecution, prosecutors should consider the effectiveness of the firm's compliance program, whether it promptly reported, and its level of cooperation with the government. The Holder Memo indicated that prosecutors should not prosecute firms that had satisfied all their enforcement obligations. Prosecutors were left with considerable discretion about how to handle firms which satisfied some, but not all, of their enforcement duties. Firms exempt from criminal prosecution based on good corporate policing nevertheless could be, and often were, subject to civil penalties.

In 2003, the Holder Memo was superseded by the Thompson Memo. The Thompson Memo encouraged prosecutors to focus on the "authenticity" of cooperation as a precondition for non-indictment and added "pretrial diversion" (e.g., deferred prosecution) to the other options available to prosecutors seeking to reward good corporate conduct.⁴⁵ Following the adoption of the Thompson Memo, prosecutors increasingly employed DPAs and NPAs, under which they agreed not to prosecute only if firms satisfied certain conditions.

D. Structural Reforms Mandated Through DPAs and NPAs

Initially, prosecutors usually used DPAs and NPAs to give them leverage over corporations, in order to ensure that corporations paid any monetary penalties imposed (including by state authorities) and continued to cooperate with the federal prosecution of any individual wrongdoers. Yet, over time, leading prosecutors' offices changed their approach. They started using these agreements to impose on non-convicted firms the type of internal governance reforms that the Guidelines had encouraged them to impose on convicted firms, such as requiring firms to adopt prosecutor-sanctioned compliance programs. Moreover, prosecutors started requiring firms to hire corporate monitors with broad authority to oversee firms' operations, and sometimes with authority to intervene in internal operations. Through these measures, prosecutors no longer sought simply to *induce* firms to engage in effective prevention and policing. They now sought both to dictate to firms both how they should deter wrongdoing and to directly supervise their efforts to comply. In so doing, prosecutors in effect stepped out of their traditional role and into a role usually assumed by civil regulatory authorities.

IV. DETERRING CRIME WITHOUT GOVERNANCE BY PROSECUTORS

Prosecutors' use of DPAs and NPAs to impose structural reforms and monitors on publicly held firms represents a fundamental shift in the goals that motivated both the Organizational Sentencing Guidelines and the Holder memo. The reforms of the 1980s and 1990s were intended to deter corporate crime by both targeting federal prosecutions at wrongful executives and providing corporations with strong financial incentives to adopt effective prevention and policing measures. The premise was that corporations—at least those entitled not to be convicted—could best determine for themselves what measures would best enable them to fulfill their compliance duties. Federal regulators could provide any additional needed oversight or regulation. Structural reform DPAs and NPAs

represent a determination that the federal authorities in charge of criminal enforcement should not only act to detect and sanction wrongs—and induce corporations to cooperate—but they also should intervene directly in the affairs of unconvicted (and usually unindicted) corporations to help ensure compliance.

Many reasons exist to question the wisdom of this approach as applied to publicly held firms. Of particular importance, this approach allows prosecutors to assume authority to make decisions affecting the very structure of how a corporation is run—authority usually enjoyed by its board of directors—notwithstanding the fact that prosecutors rarely have either any experience working for or running a business or a deep understanding of the industry being regulated. They also have only a limited understanding of the internal workings of the specific corporations that the compliance program would apply to. Moreover, prosecutors' offices rarely employ any institutional mechanisms for auditing or collecting information on the effectiveness of any reforms imposed, in order to evaluate whether the measures are cost-effective. Finally, they are subject to little if any genuine oversight and have no formal mechanisms for public feedback.

The limitations of prosecutorial imposition of structural reforms raise the question of whether it is possible to achieve the deterrence goals of corporate liability without granting prosecutors the authority to impose internal structural reforms on publicly held firms—particularly those that have not been indicted. It is. The answer lies in recognizing that, although there arguably are situations where non-convicted publicly held corporations will not attend properly to compliance unless federal authorities intervene more directly in their internal affairs, those situations are likely to be rare. Moreover, there is no reason why this intervention needs to be done by prosecutors, when there exists a civil regulator with authority to intervene.

A. Deterring Crime without Prosecutor Supervision of Compliance

As previously explained, a central goal of corporate liability is to induce corporations to help deter crime by monitoring for wrongdoing, and, if any wrongs are detected, by reporting wrongdoing to federal authorities, and cooperating with investigations to help identify and sanction all culpable individuals. Corporate liability is needed to induce firms to undertake these policing expenditures because, without the threat of liability for failure to do so, they often will find that the cost of policing exceeds the benefits. Corporate criminal liability can be used to induce corporations to monitor, report, and cooperate if it is structured in such a way that a firm that assists the government in the detection of crime faces a lower *expected* sanction than a firm that does not—where the expected sanction is the actual sanction adjusted by the probability of detection.⁴⁶ Given that policing inevitably increases the probability that a firm is sanctioned, the only way that the government can induce corporations to police is to ensure that the sanction imposed on them when they do is *much* lower than the sanction imposed on them when they do not.⁴⁷

Federal authorities generally can accomplish this goal through a two-step mitigation regime. Firms should face default civil liability whenever an employee

commits a crime in the scope of employment. The firm should face an additional penalty if it did not have an effective compliance program and a second penalty if it failed to report and cooperate.

The best way to ensure that firms have adequate incentives to satisfy each aspect of policing is to ensure that they can be confident of benefiting from one aspect of policing (for example, cooperation), even if they are not sure that they will satisfy their duties with respect to the other aspect (for example, compliance).⁴⁸ To induce reporting and cooperation, the government must give publicly held firms credit for reporting and cooperating even if the firm's compliance program was ineffective. In turn, a firm must expect to get credit for adopting an effective compliance program even if the board thinks the firm might later fail to promptly report or cooperate (for example, because of resistance by executives).⁴⁹

This analysis has important implications for the debate over prosecutorial authority over corporate compliance. It demonstrates that federal authorities must evaluate the effectiveness of corporate compliance programs, imposing higher sanctions on firms that fail to adopt effective compliance programs than on firms that adopt and supervise an effective compliance program. This ability to review compliance programs, and to penalize those that are inadequate, inevitably grants federal authorities *de facto* ability to induce firms to adopt compliance programs likely to satisfy federal authorities.

Yet it also reveals that there is no particular reason why federal *prosecutors* should be in charge of assessing compliance program effectiveness. As previously explained, federal authorities cannot induce effective policing unless they separately reward effective monitoring and effective reporting and cooperation. Federal authorities could effectively do this by encouraging prosecutors to base their charging decisions on whether the firm self-reported and cooperated. Prosecutors can tell corporations that any publicly held firm that self-reports detected wrongdoing and fully cooperates is exempt from prosecution. Civil regulatory authorities could then determine the magnitude of the civil sanction based on whether the firm had an effective compliance program, imposing a higher sanction on firms that did not than on those that did.⁵⁰

Moreover, and more importantly, the preceding analysis reveals that federal prosecutors can achieve the goals of corporate criminal liability without using DPAs and NPAs to impose structural reforms on publicly held firms as a precondition of non-indictment. First, when liability is structured properly, federal authorities rarely should need to require publicly held firms to adopt firm-specific structural reforms because the threat of liability for ineffective compliance should induce firms to take compliance seriously. Second, in those relatively rare circumstances where federal authorities may need to mandate firm-specific structural reforms,⁵¹ there is no particular reason why these mandates should be imposed by federal prosecutors. Indeed, analysis of the relative institutional expertise and structures of prosecutors and regulatory agencies reveals that federally-mandated structural reforms are most likely to be effective if the task of designing and imposing structural reforms is left entirely to federal

civil regulators, at least in the areas over which they have jurisdiction and competence.

Federal prosecutors step outside their proper role and institutional expertise when they require publicly held corporations to accept structural reforms as a precondition of not being prosecuted. It is true that federal criminal law does impose specific duties on firms in some circumstances. When it does, prosecutors are within their rightful authority to require that firms adhere to these duties as a condition of probation or non-prosecution. Similarly, prosecutors operate within the traditional confines of the criminal law when they decide to subject firms to a higher penalty if the firm actively encouraged a crime or failed to take active steps to deter it. But most DPAs and NPAs that mandate structural reforms do not restrict themselves to measures previously required by Congress or a federal regulatory agency. Instead, they require firms to adopt internal reforms that are not required by either a statute or an agency ruling as a precondition for not being indicted. In so doing, prosecutors are crossing the line from criminal enforcement to direct regulation, a line that they generally should not, and need not, cross. The task of imposing structural reforms should, wherever possible, remain the purview of civil regulatory authorities.

Federal civil regulators should be granted sole authority over whether to impose structural reforms because they are more likely to have the expertise needed to determine when and which structural reforms are needed. Federal authorities seeking to design an effective compliance program and monitor corporate behavior must attend carefully to the most likely sources of criminal activity within an industry and a specific firm, and they must evaluate the best way to deter such activity without hobbling the firm excessively. To do this effectively, authorities must have expertise that reaches beyond the criminal arena. They must understand business operations, both in general and in the industry in question. Civil regulators often come from industry, and thus often have first-hand knowledge of both the factors in a given industry that are likely to induce people to violate the law and the compliance measures that are best able to detect such wrongs. Moreover, civil regulators also often have better information about what structural reforms are needed because they tend to be engaged in long-term formal and informal dialogues with regulated firms, and thus have better information about the costs of various compliance measures.

Prosecutors, by contrast, generally have little direct experience working in the industry in question. Indeed, many have little experience working for any business. Moreover, many prosecutors evaluating compliance programs have little long term experience regulating firms in the industry in question. Accordingly, they often lack the expertise needed to assess the best way to achieve effective compliance. As a result, prosecutorial assertion of authority tends to lead towards the adoption of standardized boilerplate compliance measures, which are expensive and may not be tailored to the special risks or concerns of individual firms or particular industries. These mandated reforms not only are expensive, they also may inhale resources the firm otherwise could have used to adopt more effective measures better tailored to its situation.

In addition, prosecutors appear to be more likely than are civil regulators to impose unnecessarily costly or ineffective structural reforms because few (if any) formal mechanisms exist to ensure that prosecutors imposing DPAs and NPAs learn from either their own mistakes or those of other prosecutors. Many DPAs and NPAs enable prosecutors to exert supervisory authority over a firm for an extended period of time. Yet prosecutors' exercise of this authority is subject to little, if any, oversight. Moreover, prosecutors rarely receive the kind of detailed ongoing information about either the firm or the industry to enable them to reevaluate their decisions. Nor do prosecutors' offices have the ability to conduct the type of industry-wide cost-benefit assessments of program effectiveness needed to mandate reforms which are effective on average. Without the incentive or the ability to conduct ongoing studies of their own decisions to determine which ones work, there is little reason to expect that the benefits of prosecutor-mandated programs are worth the cost.

By contrast, federal regulatory agencies often gain firm-specific information and industry-specific information over time. They also have the institutional ability to conduct ongoing empirical assessments of the effectiveness of their own measures,⁵² as well as industry-wide assessments of how best to induce compliance. Civil authorities also are subject to considerably more oversight, since they are required to act in the open, and risk potential challenge on cost-benefit grounds. Finally, civil authorities are better able to adopt procedures to enable corporations to obtain *ex ante* input on the effectiveness of compliance measures.

Thus, federal civil regulators with authority over the firm generally are in the best position to determine both whether to impose any structural reform on a firm, and, if so, which reforms should be imposed. They also can better assess whether the reforms should be firm-specific or industry-wide. Thus, federal prosecutors should retain their policy of not indicting firms that self-report and cooperate, but should refrain from using this authority to gain leverage to force firms to adopt structural reforms, so long as there exists a competent civil regulatory agency with the ability to impose structural reforms as part of its own enforcement process.⁵³

V. CONCLUSION

Deterring corporate crime is an important goal of federal law. Yet federal law can only achieve this goal if it is properly structured. In particular, firms need strong *ex ante* incentives to adopt effective compliance programs. They also need strong *ex post* incentives to report detected wrongdoing and cooperate in the conviction of responsible individuals. Until recently, federal criminal authorities attempted to achieve these goals through the use of financial incentives, in the form of the threat of criminal and civil sanctions for corporate crime and the offer of leniency for good corporate citizens. They did not seek to regulate the internal corporate governance of individual firms. During this decade, however, federal prosecutors have asserted broad authority to interfere in the internal affairs of firms potentially subject to prosecution by using the threat of indictment to induce

firms to agree to structural reforms and corporate monitors, in return for an agreement not to prosecute.

While well-intentioned, federal prosecutors generally should be precluded from exercising this quasi-regulatory authority whenever there is a civil enforcement authority well-positioned to oversee compliance. This complete grant of authority to civil enforcement authorities to regulate corporate compliance (where possible) is superior to the current approach because civil authorities are better positioned to design compliance programs because they generally have a deeper understanding of the regulated industry and also have formal mechanisms to permit internal assessment of their own policies. This approach will remove prosecutors from where they do not belong, thereby better enabling those authorities with the requisite expertise to regulate corporate compliance where necessary.

Endnotes

* Norma Z. Paige Professor of Law, New York University School of Law. I benefitted from the helpful comments of Albert Alschuler, Miriam Baer, Anthony Barkow, Rachel Barkow, Pamela Bucy, Samuel Buell, Brandon Garrett, Robert Lee Hotz, Julie O'Sullivan, Ellen Podgor, Steven Schulhofer, and Chris Slobogin. I also wish to thank Rachel Jones for her assistance.

¹ The DOJ leniency policy for corporations provides directors with an incentive to cooperate and report because to the extent that directors expect shareholders to lay the blame for corporate criminal liability at the directors' feet, if the corporation winds up being indicted because the directors either failed to report detected wrongdoing or failed to cooperate fully. Directors will be particularly inclined to satisfy their duty to report and cooperate to the extent that shareholders are able to replace them easily.

² Memorandum from Eric Holder, Deputy Attorney General, U.S. Dep't of Justice, to Heads of Department Components and United States Attorneys (June 16, 1999), <http://www.usdoj.gov/criminal/fraud/docs/reports/1999/chargingcorps.html>; see also U.S. DEP'T OF JUSTICE, U.S. ATTORNEYS' MANUAL, § 9-28.900 (Principles of Federal Prosecution of Business Organizations), available at <http://www.usdoj.gov/opa/documents/corp-charging-guidelines.pdf>; see Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 753 (1997) (explaining the essential deterrence function of civil liability when corporations can avoid criminal liability if they satisfy their policing duties). DOJ policy also takes into account the effectiveness of a firm's compliance program in determining whether to indict. See Holder memo, *supra*. Nevertheless, prosecutors appear to focus on corporate reporting and cooperation in deciding whether to indict because these activities directly affect their ability to identify and punish the individuals responsible for the wrong.

³ See *New York Cent. & Hudson River R.R. Co. v. United States*, 212 U.S. 481, 493 (1909). The benefit requirement does little to restrict the scope of liability because it is satisfied if the employee incidentally intended to benefit the firm, even if his primary goal was to benefit himself. Thus, corporations can be criminally liable for officers' materially misleading statements to securities markets even though such securities frauds hurt shareholders by both dissuading them from acting (to sell stock or remove management) and by subjecting the firm to a reputational sanction when the truth is revealed. See Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. ILL. L. REV. 691, 729-30 (1992).

⁴ E.g., *United States v. Twentieth Century Fox Film Corp.*, 882 F.2d 656, 660-61 (2d Cir. 1989); *United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1004 (9th Cir. 1973).

⁵ By contrast, other countries generally restrict corporate criminal liability to crimes by senior managers or allow a formal good faith defense. See generally Sara Sun Beale & Adam G. Safwat, *What Developments in Western Europe Tell Us About American Critiques of Corporate Criminal Liability*, 8 BUFF. CRIM. L. REV. 89, 155 (2005); Angelo Castaldo and Giorgio Nizi, *Entity Liability and Deterrence: Recent Reforms in Italy*, 3 ERASMUS L. & ECON. REV. 1, 6 (2007); Kensuke Ito, *Criminal Protection of the Environment and the General Part of Criminal Law in Japan*, 65 INT'L REV. PENAL L 1043 (1994); Gudrun Stangl, *Austria: Corporate Criminal Liability*, 24 INT'L FIN. L. REV. 75-76 (2005); Jennifer G. Hill, *Corporate Criminal Liability in Australia: An Evolving Corporate Governance Technique?*, 2003 J. BUS. L. 1 (2003).

⁶ See generally Cindy R. Alexander, Jennifer Arlen, & Mark A. Cohen, *Regulating Corporate Criminal Sanctions: Federal Guidelines and the Sentencing of Public Firms*, 42 J. LAW & ECON. 393 (1999).

⁷ Holder memo, *supra* note 2.

⁸ While prosecutors employed a DPA as far back as 1994, Mary Jo White, *Corporate Criminal Liability: What Has Gone Wrong?*, 2 37TH ANN. INST. SEC. REG. 815, 818 (PLI Corp. Law & Practice, Course Handbook Series No. B-1517) (2005), their use increased significantly after the

Thompson Memo in 2003. See, e.g., Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. REV. 311, 323 (2007); Peter Spivack & Sujit Raman, *Regulating the “New Regulators”*: Current Trends in Deferred Prosecution Agreements, 45 AM. CRIM. L. REV. 159, 163, 166-67 (2008). Also, earlier DPAs and NPAs generally did not have some of the common and controversial features of modern DPAs, such as waiver of attorney-client privilege, material structural reforms, and the appointment of an independent compliance monitor. See Griffin, *supra*, at 323; see also Miriam H. Baer, *Governing Corporate Governance*, 50 B. C. L. REV. 949, 969-70 (2009).

⁹ See, e.g., Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 898-99 (2007); Spivack & Raman, *supra* note 8, at 184-87.

¹⁰ For example, KPMG International agreed to eliminate its private tax practice. Garrett, *supra* note 9, at 855.

¹¹ See, e.g., Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar*, 105 MICH. L. REV. 1713, 1724 (2007).

¹² Although firms often complain that prosecutors enjoy nearly unfettered discretion to decide whether to indict or prosecute, any problems associated with this discretion are not unique to corporate criminal law, and thus are best addressed through general solutions that are not limited to executives and corporations. See Sara Sun Beale, *Is Corporate Criminal Liability Unique?*, 44 AM. CRIM. L. REV. 1503, 1523-1529 (2007).

¹³ Interview with Mary Jo White, 19 CORP. CRIME REP. 48 (Dec. 12, 2005). Prosecutors' insistence in another case that a corporation refuse to honor its contractual obligations to pay for its employees attorneys' fees arguably represents another prosecutorial abuse of power. See *United States v. Stein*, 435 F. Supp.2d 330, 362-65 (S.D.N.Y. 2006).

¹⁴ Memorandum from Mark Filip to Holders of the U.S. Attorneys' Manual, Non-Prosecution Agreements and “Extraordinary Restitution” (May 14, 2008); see Memorandum from Craig S. Moreland to heads of Department Components and U.S. Attorneys re: Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations (March 7, 2009).

¹⁵ The present objections do not apply to structural reforms that are merely window dressing, as when DPAs and NPAs are limited to provisions that a firm planned to adopt in any event and prosecutors exercise no post-agreement oversight. Of course, such agreements raise other problems since prosecutors' appearance of action may dissuade others, such as shareholders, from intervening more effectively.

¹⁶ By contrast, Delaware has taken a largely hands-off approach to compliance programs. Delaware imposes a duty on directors to attend to compliance, but vests them with full authority to determine how best to satisfy that duty, subject to a threat of liability only if they act in bad faith by utterly failing to satisfy their compliance duties. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (en banc); see also *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996). Delaware does not hold directors liable for gross negligence for failure to monitor in order to give directors leeway to exercise their good faith discretion. Delaware also focuses on maximizing firm value, and not guaranteeing compliance with federal law at any cost. See Jennifer Arlen, *The Story of Allis-Chalmers, Caremark, and Stone: Directors' Evolving Duty to Monitor*, 323, in CORPORATE LAW STORIES (J. Mark Ramseyer, ed., 2009).

¹⁷ Mark Cohen, *Corporate Crime and Punishment: An Update on Sentencing Practice in the Federal Courts, 1988-1990*, 71 B.U.L. REV. 247, 268 (1991) (between 1988 and 1990, individual codefendants were *not* convicted in 35% of the federal cases in which an organization was sentenced for a non-antitrust crime); see Leonard Orland, *The Transformation of Corporate Criminal Law*, 1592 1 BROOKLYN J. CORP., FIN. & COMM. L. 197, 201 (PLI Corp. Law & Practice, Course Handbook Series No. 1592) (2007) (observing that corporate executives were rarely convicted prior to 1960). Publicly held firms convicted prior to the Holder Memo include General Electric, Twentieth Century Fox, Disney, Emerson Electric, Waste Management, Boeing, Texaco,

Baxter International, Borden, Shell Pipeline, Exxon, AT&T Microelectronic, Mitsubishi, Nynex, Chevron, Archer Daniels, Rocketdyne, Warner Lambert, Hyundai Motors of America, Samsung America, Daiwa Bank, and Bristol-Myers Squibb.

¹⁸ Cohen, *supra* note 17, at 254–256.

¹⁹ See Garrett, *supra* note 9, at 855.

²⁰ Cohen, *supra* note 17, at 251-52 (noting that the vast majority of federal convictions involved closely held firms).

²¹ E.g., Cindy R. Alexander & Mark A. Cohen, *New Evidence on the Origins of Corporate Crime*, 17 *MANAGERIAL DEC. ECON.* 421, 432 (1996); see also Arlen & Carney, *supra* note 3, at 692-93.

²² See *supra* note 1.

²³ See Alexander Dyck, Adair Morse, & Luigi Zingales, *Who Blows the Whistle on Corporate Fraud?* *J. FINANCE* (forthcoming), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=891482 (less than 7 percent of corporate frauds committed between 1996 and 2004 were detected by the SEC; only 13% were detected by non-financial market regulators).

²⁴ See Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 *J. LEGAL STUD.* 833, 847 (1994); Arlen & Kraakman, *supra* note 2, at 690-91.

²⁵ Studies show that employees (including officers) are more likely to commit certain crimes when their firms focus on short term financial returns when evaluating the performance of a division or individual. E.g., Charles W. L. Hill et al., *An Empirical Examination of the Causes of Corporate Wrongdoing in the United States*, 45 *HUM. REL.* 1055, 1069-70 (1992) (finding that EPA and OSHA violations are more likely when top managers focus on rate of return criteria in evaluating division performance); see Mark A. Cohen & Sally S. Simpson, *The Origins of Corporate Criminality: Rational Individual and Organizational Actors*, in *DEBATING CORPORATE CRIME: AN INTERDISCIPLINARY EXAMINATION OF THE CAUSES AND CONTROL OF CORPORATE MISCONDUCT* (William S. Lofquist, Mark A. Cohen, and Gary A. Rabe, eds., 1997). For additional analysis of this issue, see N. Craig Smith, Sally S. Simpson & Chun-Yao Huang, *Why Managers Fail to do the Right Thing: An Empirical Study of Unethical and Illegal Conduct*, 17 *BUS. ETHICS QUAR.* 633 (2007).

²⁶ See, e.g., Tom R. Tyler & Steven L. Blader, *Can Business Effectively Regulate Employee Conduct? The Antecedents of Rule Following in Work Settings*, 48 *ACAD. MGMT. J.* 1143, 1153 (2005); John M. Conley & William M. O'Barr, *Crimes and Custom in Corporate Society: A Cultural Perspective on Corporate Misconduct*, 60 *LAW & CONTEMP. PROBS.* 5, 19 (1997).

²⁷ See Arlen, *supra* note 24, 839-40; Arlen & Kraakman, *supra* note 2, at 691.

²⁸ See, e.g., Arlen & Kraakman, *supra* note 2, at 691-693, 699; Samuel W. Buell, *Criminal Procedure Within the Firm*, 59 *STAN. L. REV.* 1613, 1626 (2007).

²⁹ The central difference between corporate “policing” and corporate “prevention” (as defined above) is that the latter simply deters crimes directly, whereas policing deters crime by increasing the likelihood that the government can detect and sanction wrongdoing. Arlen & Kraakman, *supra* note 2, at 701-12.

³⁰ Indeed, firms may benefit from a lax attitude towards crime either because they benefit directly from the crime itself (if not sanctioned) or indirectly from the extra productivity generated by promotion and compensation policies known to increase the risk of crime. See *supra* note 25.

³¹ A corporation potentially can reduce the reputational penalty of any crimes it reports if it can act to reassure the markets that the criminal activity will not reoccur, for example by replacing the CEO and other senior managers with an outsider. These actions do not eliminate the penalty, however, and indeed may impose their own costs on the firm.

³² Under *respondeat superior* liability, the firm does not have a net incentive to police if the deterrence effect of policing on employees' willingness to commit crimes is less than the cost to the firm of its increased liability resulting from its liability for the crimes that it detects and reports that otherwise would have remained unsanctioned. Arlen, *supra* note 24, at 836; see Arlen & Kraakman, *supra* note 2, at 712–717.

³³ Consistent with this, Delaware law held that directors are not obligated to adopt a compliance program absent notice of potential wrongdoing. *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963). Delaware changed its approach after federal authorities abandoned strict corporate criminal liability. See Arlen, *supra* note 16.

³⁴ See text accompanying notes 18-19 (discussing sentencing prior to the Guidelines).

³⁵ See U.S. Sentencing Commission, *Guidelines Manual* Ch. 8, §§ Section 8B1; 8D1 [hereinafter the Guidelines].

³⁶ Alexander, Arlen & Cohen, *supra* note 6, at 410. In 2005, the Guidelines became advisory, and not mandatory. See *United States v. Booker*, 543 U.S. 220, 223-24 (2005).

³⁷ This estimate excludes the \$10.3 billion total sanction imposed for the Exxon Valdez. *Id.*

³⁸ Alexander, Arlen & Cohen, *supra* note 6, at Table 4.

³⁹ Guidelines, *supra* note 35, at § 8D.

⁴⁰ *Id.*

⁴¹ Under the Guidelines, a firm potentially becomes eligible for a reduced sanction if the offense occurred while they had an effective program in place to prevent and detect violations and the firm reported all detected violations within a reasonable time after becoming aware of them. Guidelines, *supra* note 35, at § 8C2.5(f). It can earn additional mitigation by reporting wrongdoing, fully cooperating in its investigation, and accepting responsibility for wrongs that have already occurred. Guidelines, *supra* note 35, at § 8C2.5(g).

⁴² In many industries, firms convicted of a crime face substantial collateral consequences which are completely independent of the level of fine involved. For example, they may be barred by federal or state regulators from engaging in certain activities. In addition, corporations in the business of selling their reputation can expect to suffer a huge reputational penalty if convicted of a crime.

⁴³ See Arlen & Kraakman, *supra* note 2, at 690.

⁴⁴ Holder Memo, *supra* note 2. Prior to the Holder memo, various federal enforcement agencies adopted a similar approach to particular crimes, such as government procurement fraud, antitrust, and environmental laws. U.S. Environmental Protection Agency, Final Statement, Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations, 60 Fed. Reg. 66,706 (Dec. 22, 1995); Antitrust Division, U.S. Department of Justice, Corporate Leniency Policy (August 10, 1993), 328 Trade Reg. Rep 20,649-21 ¶ 13,113 (Aug. 16, 1994).

⁴⁵ See Memorandum from Larry D. Thompson, Deputy Attorney General, U.S. Dep't of Justice, to Heads of Department Components and United States Attorneys (Jan. 20, 2003), available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

⁴⁶ To be precise, the government must set sanctions so that the firm's expected costs if it engages in policing— $PolicingCosts + (Probability\ Sanction_{if\ police})(Sanction_{if\ police})$ —are less than its costs if it does not, as given by $(Probability\ sanction_{no\ policing})(Sanction_{no\ policing})$. Thus, the firm must face a lower *expected* sanction if it polices than if it does not, even though the probability of sanctioning is higher if it polices.

⁴⁷ Arlen & Kraakman, *supra* note 2, 706-12.

⁴⁸ *Id.* at 728-29.

⁴⁹ *Id.* at 729.

⁵⁰ Federal agencies must ensure that firms that police nevertheless expect to pay for the harm caused by their employees' crimes, for example through civil sanctions. This "residual" liability is needed to ensure that firms have an incentive to prevent crime even when they expect to avoid

criminal liability and to receive credit for effective monitoring. Liability is superior to direct regulation because it gives each firm an incentive to make the right choice given the particular circumstances facing that firm. *See id.* at 701-705. Federal agencies can grant full mitigation, however, if the firm will bear the cost of the crime through either reputational sanctions or private actions for damages.

⁵¹ The situations where such mandates may be required or useful are beyond the scope of this chapter, but include situations where managerial agency costs are so severe that federal authorities cannot induce needed reforms through sanctions imposed on the firm. Recent reforms giving shareholders greater access to the ballot may reduce the need for such interventions, however.

⁵² *See, e.g.,* Baer, *supra* note 8, at 1004.

⁵³ Of course, federal agencies cannot necessarily be relied upon to use their expertise in the public interest since they are subject to capture. This concern is evident in debates about the recent role of the SEC. This suggests a potential role for prosecutors if federal agencies appear to be captured. Yet this raises the issue of whether this role is best assumed by federal or state prosecutors. *See Rachel Barkow ...*