1980

Making the Punishment Fit the Corporation: The Problem of Finding an Optimal Corporation Criminal Sanction

John C. Coffee Jr.
Columbia Law School, jcoffee@law.columbia.edu

Follow this and additional works at: https://scholarship.law.columbia.edu/faculty_scholarship

Part of the Business Organizations Law Commons, and the Criminal Law Commons

Recommended Citation
Available at: https://scholarship.law.columbia.edu/faculty_scholarship/616

This Article is brought to you for free and open access by the Faculty Publications at Scholarship Archive. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Scholarship Archive. For more information, please contact donnelly@law.columbia.edu.
Making the Punishment Fit the Corporation: The Problems of Finding an Optimal Corporation Criminal Sanction

John C. Coffee, Jr.*

To be "present at the creation," in Dean Acheson's felicitous phrase, is always an honor. In addition, to be present at the commencement of what I expect will be a sustained and fruitful tradition at this law school, namely, the Governor Thompson Lectureship, is a second honor. Finally, let me express my thanks to Dean Bainbridge for a third honor: the compliment implicit in the 2 to 1 odds he has arranged today. Both Norval Morris and Mark Crane are men with distinguished careers in quite different fields of the law. If I am confident of one thing today, it is that I will be able to provide a broad enough target for both of them to demonstrate their very accurate marksmanship.

By time honored tradition, all discussions of the topic on which I am about to embark begin with the same caveat: there are no simple answers; the problem is complex, the trade-offs uncertain.

On the premise that an ounce of history is sometimes worth a pound of logic, particularly when one is approaching a complex and indeed confused topic, let me begin with a somewhat whimsical chronology. Two unmarked milestones exist in the frustrating history of the criminal law's unsuccessful attempts to come to grips with the problem of corporate criminal behavior. First, about the year 1250 A.D., Pope Innocent IV forbade the practice of excommunicating a corporation which had been convicted of a crime. His logic was unassailable: since the corporation had no soul, it could not lose one. Nonetheless, this represents the first recorded instance on which the authorities made the criminal penalties for corporate misbehavior less severe than those for individual misconduct. Regrettably, no criminologist was then on the scene to do a

* Professor of Law, Georgetown University Law Center; B.A. 1966, Amherst College; LL.B. 1969, Yale Law School. All rights reserved. This material may not be quoted, reproduced, or otherwise used without the express permission of the author.
time series “before and after” study of the effect of this change on corporate misbehavior. In any event, this pattern of lesser penalties for the corporation has continued for a number of reasons, not the least of which is that no one has yet found a way to send the corporation to prison.

My second uncelebrated moment of history comes in the 19th Century when Edward, First Baron of Thurlow (1731-1806), the Land Chancellor of England, was faced with a convicted corporation awaiting sentence. Obviously perplexed, he uttered a remark from the bench that has survived. He asked, “How can you ever expect a corporation to have a conscience, when it has no soul to be damned and no body to be kicked?” No soul to damn; no pants to kick! This is the dilemma of corporate deterrence that I wish to address.

The topic of corporate punishment has received only the sporadic attention of the academic legal community. Like the seventeen-year locust, it attracts considerable interest at widely spaced intervals. In the 1950’s, the Model Penal Code faced this topic squarely, and recommended a special penalty equal to double the gain or loss derived from, or caused by, the offense. In the 1960’s, after the major electrical equipment price-fixing scandal, corporate punishment was addressed by several distinguished legal scholars, among them Sanford Kadish and Alan Dershowitz.¹ At the end of that decade, the National Commission to Reform the Federal Criminal Code (the “Brown Commission”) began to grapple with the issue and proposed several new sanctions: restitution, disqualification from corporate office, and a judicial order whereby the convicted corporation would have to notify its victims of the fact of its conviction. The prolonged gestation process of the Federal Criminal Code is still continuing, and whether these provisions will survive in a meaningful form is in doubt. But a new dimension to the problem of corporate crime has come into clearer focus since the days of the Brown Commission: today, we are less concerned with simple regulatory crimes—e.g., antitrust, tax and securities law violations—and more with environmental and safety violations which threaten the public health and safety. In this latter context, the tendency is more pronounced for the cost of compliance with a

statute to be less than the penalty cost for violating it. The recent Ford Pinto case in Indiana illustrates this tendency: the crime charged (homicide) was hardly a merely regulatory one, and yet, if Ford had been convicted, it faced a maximum fine of only about $35,000. Conversely, the cost savings to Ford were considerable: although the State of Indiana charged that only an $11 cost difference would have produced a "safe" gas tank, some 12.5 million cars with the allegedly unsafe tank design were produced.

Let me confess at the outset that I have only a few suggestions to present, none of which provide a complete solution standing alone. What I intend to do, however, is to move beyond the traditional liberal answer (i.e., that special enhanced fine schedules should be adopted for organizational offenders) and suggest some more novel remedies. More importantly, I intend to suggest some criteria by which organizational penalties should be judged; these criteria involve a melding of concepts from both the corporate and the criminal law and the introduction of the social scientific perspectives of the economist and the student of organizational behavior. Such an assigned task suggests more the heroism of Don Quixote than that of Hercules, and hence some immediate qualifications are in order:

(1) I will not address some of the larger questions connected with the use of the criminal sanction, such as, is it indeed superior to civil remedies in deterring organizational behavior? Or, should we focus on deterring the individual decisionmaker rather than the organization? These are both weighty questions, but I will evade them for now by replying that since our society insists on applying criminal sanctions to organizations, we should at least rationalize the penalty structure for organizations.

(2) Necessarily, many possible qualifications, exceptions, and caveats will be omitted, but, in the end, I doubt that these would alter the fundamental analysis.

THE PROBLEMS DEFINED: THE PARAMETERS OF CORPORATE DETERRENCE

What makes corporate crime difficult to deter? Here, I will advance three propositions: the first, a traditional legal observation; the second, an economic one; and the third, a behavioral approach.

For the sake of convenience, let us call the first proposition the "Spill-Over" problem: Because the incidence of a financial penalty imposed on the corporation falls ultimately on persons who are seldom culpable, courts resist imposing severe financial penalties. Put simply, the costs of deterrence tend to spill over onto the relatively innocent. Corporations are not the ultimate cost-bearers of a penalty.

The over-spill of corporate punishment has three distinct levels, each progressively more serious. First, stockholders bear the penalty in the form of a reduced value to their security; similarly, bondholders and other creditors also suffer a diminution in value to reflect the increased riskiness of the enterprise. This point has been made many times by, among others, the Model Penal Code, and such respected legal scholars as Francis Allen, Sanford Kadish, and Alan Dershowitz. It should be carried one step further: the secondary incidence of a severe financial penalty falls on parties even less culpable than the stockholders. As a class, the stockholders can at least be said to have received unjust enrichment from the benefits of the crime; this arguably justifies their indirectly bearing a compensatory fine. However, if the fine is severe enough to threaten the solvency of the corporation, the predictable response will be wholesale dismissal and layoffs of lower echelon employees, who received no benefit from the earlier crime. Finally, there is the tertiary incidence of a financial penalty: it may be passed on to the consumer. If the corporation competes in a product market characterized by imperfect competition (i.e., if it operates in the "real world"), then, to this degree, the fine may be recovered from consumers in the form of higher prices. If this happens, not only does the "wicked" corporation go unpunished, but the likely beneficiary of the criminal statute which was violated (i.e., the consumer) ends up bearing the incidence of its penalty. Even if this paradoxical result does not occur, it would still seem to be true that severe financial penalties interfere with announced public goals, such as full employment and minority recruitment, by restricting corporate expansion.

As a matter of logic, all of this explains why a sentencing court may pull its punch and mitigate the severity of authorized penalties in the case of corporate offenders. In any event, an ounce of history is here again worth a pound of logic. In actual fact, the fines imposed for corporate offenders have been small and well below the authorized maximums. In the great electrical equipment price-fixing conspiracy of the 1950's—probably the most famous
and publicized price-fixing conspiracy in American history—the average fine imposed upon each corporate offender was $16,550. General Electric paid the largest fine, $437,500, which amounted to 0.001% of its net profit. Empirical studies show that the fines in the typical antitrust case have seldom approached the maximum authorized. At present, the maximum authorized fine stands at $1,000,000 for corporate antitrust violations (which is the same maximum that the Senate bill would codify for all corporate felonies). Yet, between 1967 and 1970, when the maximum fine was only a lowly $50,000 per count, the Justice Department itself recommended the imposition of the maximum fine in only 27% of the cases in which it obtained convictions. If even the prosecutor will not recommend a penalty of $50,000 per count, it is little wonder that the judges resist Draconian sentences.

Is the answer then to legislatively impose mandatory penalties which judges may not undercut? I think not. Even if one were willing to accept the negative social consequences of such fixed penalties, it is the experience of the common law that mandatory penalties tend to be nullified in practice when the courts find them too severe. Here, evasion would be easy since white collar crime is far more a matter of definition than are the more traditional species of crime. The price then of mandatory penalties would, in all likelihood, be a distortion of the criminal law's content, as statutory substantive commands were unduly narrowed and blunted.

Having now seemingly reached a pessimistic dead end, it is time to make a second and even more disheartening assertion. Again, for the sake of convenience, I will name this premise the "Doomsday" problem: From the standpoint of traditional deterrence theory, only extraordinarily severe penalties will be sufficient to deter the most popular forms of organizational crime, because the risk of apprehension associated with them is low. The assumption of deterrence theory is that the "expected punishment cost" must exceed the expected gain if the crime is to be deterred. But the "expected punishment cost" to the offender is not simply the amount of the penalty. Rather, this amount must be discounted by the likelihood of apprehension. For example, if the risk of apprehension were 25% and the expected gain from a particular

3. For recent data, see M. CLINARD, ILLEGAL CORPORATE BEHAVIOR (National Institute of Law Enforcement and Criminal Justice 1979). See also, ELZINGA AND BREIT, THE ANTITRUST PENALTIES: A STUDY IN LAW AND ECONOMICS at 54-63 (1976).
criminal transaction were $1,000,000, the penalty would have to be not $1,000,000 but $4,000,000 in order to remove all incentive to commit the crime.

This approach to calculating the necessary level of deterrence has been expounded with considerable elegance by Professor Morris' colleagues at the University of Chicago—Professors Gary Becker and Richard Posner. To be sure, one can quibble with this model's failure to deal adequately with the factor of risk aversion, and I personally doubt that the expected punishment cost is simply the product of the penalty multiplied by the risk of apprehension. However, their central conclusion, that the expected punishment must be raised to a level well in excess of the expected gain in order to compensate for a risk of apprehension which inevitably falls well below 100%, seems unavoidable. If all we do is remove the gain when the offender is apprehended, the rational offender sees a "heads-I-win; tails-I-break-even" gamble.

If so, the problems earlier discussed of the spill-over of corporate punishment upon the non-culpable and the consequent judicial tendency toward nullification are seriously aggravated. In particular, what compounds this problem is that corporate crimes tend to be uniquely concealable. Why? Unlike homicide or even rape (a classically under-reported crime) the victim rarely learns of his injury. The victim of price-fixing seldom knows he has overpaid; the consumer of an unsafe, toxic, or carcinogenic product probably never becomes aware of the hazard risked, and even the government or a fellow competitor rarely discovers the tax fraud or illegal payment that has injured them. For such events to come to light, there generally must be a confession from within: e.g., a disgruntled employee, or a whistle-blower, or a serendipitous discovery during civil litigation.

This ease of concealment thus implies that severe financial penalties would be necessary to deter most corporate crimes. Add to this now a second obvious factor: corporate crime generally involves high stakes. That is, the money saved when a corporation fails to install adequate environmental controls, or when it markets a product having a serious design defect, is in the millions. Certainly, in the illegal payment cases, the expected gain in some

4. I do not claim, however, that all forms of corporate crime are easily concealed. Price-fixing and other collusive agreements require that the conspirators seek to obtain the cooperation of all significant entrants into the market. This fact plus the continuing character of the conspiracy make them less concealable in the long run.
cases (e.g., a defense contract from a foreign nation for jet aircraft) reached well into the tens of millions. Although precision is illusory in this context, let us use some hypothetical numbers that seem conservative enough. Assume the gain to a corporation—be it Ford in a Pinto-type case, or Allied Chemical in the Kepone dumping incident or Hooker Chemical in its Love Canal episode—is in the range of five to ten million dollars. Assume next that the probability of detection is low, between 5% and 10%. Under the formula discussed earlier, the rational offender would only be deterred if the penalty compensated for this low risk of apprehension. Thus, it would have to fall within a range whose floor was $50,000,000 (i.e., the product of a 10% probability and a $5,000,000 gain) and whose ceiling was $200,000,000 (i.e., the product of a 5% probability and a $10,000,000 gain). Is there any chance that a court would impose such a penalty? I expect not, and, indeed, I hope not. If our society deems it important to bail out Chrysler from bankruptcy, it would be extremely inconsistent for it to permit a single state sentencing judge to place Ford at the brink of insolvency.

What then will happen? In all likelihood, courts will impose a substantial fine—say $5,000,000—for which they will be suitably commended by editorialists and television commentators—but the corporation will not be adequately deterred. When this happens, the criminal justice system is simply placing a tax on corporate crime, which, although it is more than a nuisance tax, is also less than a deterrent. The rational, if amoral, corporation may continue to do business as usual.

Still, a more pessimistic conclusion must be confronted. My third assertion, the behavioral one, can be termed the “Frolic and Detour” problem. Put simply, there is an incongruence between the aims and interests of the individual and those of the organization which employs him. Even if a penalty structure is adequate to deter the corporation as an entity, individuals within the firm would, often, still have an incentive to engage in the criminal behavior in question. If we see the corporation as simply a “black box” which somehow acts in its collective self-interest as an entity, we fall prey to a serious behavioral fallacy. Students of organizational behavior agree that the individual decisionmaker within the firm does not have an identity of interests with his or her corporation.

The manager’s desire to advance within the firm, or to receive higher compensation, or to avoid disciplinary action for poor man-
agerial results, may lead him or her to take risks—either of a legal or a business nature—which are not in the interests of the firm as a whole. For example, the executive vice-president who is a candidate for promotion to president may be willing to take risks which are counter-productive for the firm as a whole because he is preoccupied with very short-run profit maximization for his division. Alternatively, the corporate official who is concerned about a hostile takeover by an acquisition-minded conglomerate may be prepared to accept risks of which the corporation's stockholders would not approve (particularly since the hostile takeover via a tender offer represents a bonanza to the stockholder).

These are, however, the less typical situations. Within the world of the corporation, the locus of corporate crime is predominantly at the middle management level. Why this is so requires a brief word of background. The modern public corporation in the United States is multidivisional and decentralized: that is, a central corporation headquarters supervises basically autonomous divisions, each of which has operational authority over most matters except those that pertain to corporate finance. Some operational decisions are delegated still further down the corporate hierarchy: plant managers effectively are autonomous in their decisions as to compliance with emission and environmental controls.

What then does senior management at the corporate headquarters do? Chiefly, it engages in strategic and financial planning. To the extent senior management becomes involved in operational decisions, it confines its role to establishing profitability goals for the autonomous divisions and then monitoring compliance. Through positive and negative incentives—e.g., salary and fringe benefit bonuses or the threat of dismissal—corporate headquarters pressures the operating division to comply with this profit goal. Thus, for example, the communication from the top of the corporate hierarchy says to increase a division's profitability this year by 15% over last year; the goal is thus set, but the means are left to the operating division and the middle manager. Properly applied, such pressure establishes and enforces accountability without sacrificing the advantages of decentralization. But not infrequently the goals set by the central office can be unrealistic, and the threat of punishment may induce the middle level manager to turn to il-

5. For a general overview, see Coffee, Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response, 63 VA. L. REV. 1099 (1977).
legal means. Paul Lawrence, a professor of organizational behavior at the Harvard Business School, recently summarized the dilemma implicit here in the following words:

A certain amount of tension is desirable. But at many companies the pressures to perform are too intense and the goals so unreasonable that some middle managers feel the only way out is to bend the rules, even if it means compromising personal ethics. ... When a manager feels his job or division’s survival is at stake, the corporation’s standards of business conduct are apt to be sacrificed.⁶

As a textbook illustration of this pattern, a Wall Street Journal article last fall cited the experience of Ford Motor.⁷ They were referring not to the Pinto case but to another incident which reveals this pattern of covert misbehavior by middle level managers trying to comply with unrealistic goals from senior management. Worried that too many 1973 model cars were failing EPA emission control tests, middle level Ford officials began altering the data by tampering with the cars undergoing federal certification tests. This test-rigging eventually resulted in Ford’s paying $7,000,000 in civil and criminal penalties. Yet, in overview, it seems unrealistic to believe that the senior management of Ford would have believed that their EPA tests could be rigged for long without detection. But for the middle level official, the question is not whether the behavior is too risky to be in the interests of the corporation from a cost-benefit standpoint. Rather, it is which risk is greater—the criminal conviction of the company, or the dismissal for failure to meet targets set by an unsympathetically demanding senior management. Because the conviction of the corporation effects him only indirectly, it can seldom exceed the penalty that dismissal or demotion means to the career-minded middle manager. Caught between “the devil and the deep blue sea,” the middle level manager then faces a very different opportunity set of potential costs and benefits than does the corporate entity itself. For example, a given crime may carry with it a 40% risk of apprehension—a level presumably too high to be very attractive to the corporation. But if compliance with the law subjects the corporate manager to a 50% chance of dismissal for failure to meet a profit quota, crime may well be attractive to him, though not to his cor-

⁶ Quoted in Getschow, Overdriver Executives: Some Middle Managers Cut Corners to Achieve High Corporate Goals, Wall St. J., Nov. 8, 1979, at 1, col. 6.
⁷ Id.
porate employer. At the least, it delays the moment at which he will face dismissal.

All this is cited to corroborate two basic contentions: (1) a penalty structure that is adequate to deter the corporation might still not deter the corporate manager—particularly in the sensitive areas of health, safety, and environmental concerns where concealment is particularly possible—because the manager faces counterbalancing disincentives; he is between Scylla and Charybdis; and (2) we need to take a behavioral view of corporate misconduct if we are to deal adequately with it. If we focus exclusively on the corporation as an entity, as I am afraid too many economists and lawyers do, then we confine ourselves to a self-imposed intellectual sandbox and ignore the important behavioral dynamics within the firm.

The time has come for a preliminary summary. First, it was argued that punitive penalties will be resisted where the punishment cost spills over beyond the corporation and falls on totally innocent parties, such as the worker, the consumer, and indeed the community which depends almost symbiotically on the corporation. Second, it was asserted that from a cost-benefit perspective very punitive penalties were necessary to deter corporate crime because of the low risk of apprehension that characterized many of its forms. In short, high penalties are necessary but infeasible. Finally, I have argued that even if the corporation can be deterred, it does not follow that individual decisionmakers within the corporation will act in its best interest because they confront an entirely different cost-benefit exchange.

What then can be done? Some answers come to mind quickly, but they are incomplete. For example, we could focus penalties less on the corporation and more on the individual decisionmaker. The rationale for such a transition is that, although corporate crime may yield enormous gains for the corporation, the benefits are generally very modest indeed for the individual manager. Hence, if the benefits are less, so may be the penalties which are adequate to deter. The neoclassical economist has always rejected this approach, arguing that there was no need to penalize the individual since, if we could deter the corporation, it would in turn discipline the aberrant individuals. This idea of utilizing the internal corporate disciplinary mechanism to enforce compliance with public goals has some merit, but it is of limited use in this form. Why? Because the key fact about corporate crime (or at least the forms of it that most concern us today) is that it may be virtually un-
CORPORATE CRIMINAL SANCTIONS

deterrable at the corporate level because we cannot reasonably ex-
pect either courts or legislatures to impose penalties large enough
to work. Thus, if we cannot deter the corporation adequately, we
cannot expect it to impose sanctions against individual officials;
rather, it may discipline the official who is “excessively” scrupu-
lous. Nor would even fuzzy-minded academics (such as I) really be
prepared to impose on society the costs and social dislocation that
fines adequate to deter the corporation would impose on others.

But, if a focus on the individual decisionmaker is part of the
answer, it cannot be all of it. Why? First, there is again the prob-
lem of nullification. Juries and judges have a distressing habit of
acquitting flesh and blood defendants whereas they would convict
a bloodless corporation. Second, it is very difficult to identify the
true decisionmaker within the organization. Decisions are shared;
responsibility is diffused. Who is responsible? The low level engi-
neer who designs the unsafe gas tank, the chief engineer who ap-
proves it, or the president who never heard of the problem but who
insisted from afar that underlings who wished to advance within
the corporate hierarchy demonstrate an ability to cut costs dra-
matically? If we say the latter, we raise disquieting issues about
the fairness and indeed constitutionality of vicarious criminal lia-
bility. Finally, even if we identify the true decisionmaker, he may
be long gone: deceased, retired, or so far removed from the scene
that his indictment would make him look like a scapegoat served
up for the slaughter. In sum, a focus on the individual deci-
dionmaker is sensible, but cannot be relied upon exclusively.

Another possibility is to abandon our concern with deterrence
and focus instead on incapacitation—i.e., the convicted corpo-
ration could be sentenced to a term of probation under conditions of
probation designed to achieve closer surveillance and monitoring.
This would be extraordinarily costly if attempted on a broad scale,
and it would represent an unpopular governmental intrusion into
the private sector. It may be necessary in some cases, but those
cases would have to be narrowly defined or, literally, we would de-
velop a system of judicial socialism with courts and probation of-
ficers running most public corporations.

What seems critically important then is to find a “socially
cheaper” means of achieving deterrence. By “socially cheaper” I do
not mean less severe, but rather a mechanism that minimizes the
spill-over of deterrence upon the innocent. Such a goal of cheaper
forms of deterrence requires us to adopt a behavioral strategy to-
ward corporate crime and seek to find what internal forces within
the firm can be turned to society's advantage. Let me explain this cryptic suggestion first by analogy and then by examples. Regrettably, both the classical economist and the conventional liberal seem to have agreed too hastily on the use of fines as the appropriate sanction by which to influence corporate behavior. Under such an approach, the state bludgeons the corporation into compliance. This strategy reminds me of two giant Sumo wrestlers circling each other before the charge: there is little room for subtlety and innocent parties may get trampled in the ensuing havoc. But what is the alternative? To extend my analogy, I suggest it is that of the judo wrestler: rather than rely on brute force like the Sumo giant, he uses his opponent's strength against him. The violence is more controlled, and the innocent are less subject to injury. The suggested policy options next outlined are intended as controlled uses of discipline which attempt, like the judo expert, to use the opponent's own force against him.

How then can we make use of the internal forces within the corporation to enhance the deterrent threat of the law? Let us begin by asking what are the principal fears and anxieties of those within the management of the corporation? Remember the terrifying scene in Orwell's 1984 when Winston Smith, the protagonist, is faced by his interrogators with the one numbing fear that he subconsciously harbors. At once, he is overcome and is unable to resist. The fear, in 1984, was of being nibbled by rats. Although I doubt that an equivalently frightening sanction can be devised for the corporate offender, there are nightmares for the corporate manager which are far greater than the possibility that his firm might be fined. Respectively, I will discuss the following three nightmares of the corporate manager and suggest how they might be put to productive use. First, there is the fear of a hostile takeover; second, there is the fear of adverse publicity and public embarrassment; and third, there is the fear of subsequent civil litigation, including the derivative suit, which can convert a corporate fine into personal liability. In overview, my basic thesis is that by making optimal use of these three fears, we can substantially evade the dilemma that the "Spill-Over" problem raises.

The Equity Fine: Toward Reducing Spill-Over

First, I suggest that where very high fines need to be imposed, they should be levied not in cash, but in the equity securities of the defendant corporation. In overview, such a strategy may substantially reduce the three obstacles just discussed: (1) we reduce
the spill-over by concentrating the penalty on the stockholder; (2) we make possible the imposition of a higher penalty than the corporation could pay in cash; and (3) we better align the manager’s self-interest with that of the corporation by increasing the threat of a change in corporate control. This assertion may be surprising because the corporation’s common stock is virtually an equivalent to cash, and the recipient of the stock may quickly convert it into cash. But there are critical differences.

First, the incidence of the penalty falls very differently when the medium of payment is stock. Why? Punitive cash fines fall ultimately on the non-culpable: stockholders, employees, consumers, and the general constituency of interests surrounding any substantial corporation. This is not, however, true if the penalty is levied in securities, since now only the stockholders bear the penalty. Thus, if the fine were levied in terms of a percentage of the corporation’s stock having the same expected monetary value as the desired cash fine, much of the motive for judicial nullification of punitive fines should substantially diminish. Let me illustrate.

Suppose in a Ford Pinto-type case, the desired fine from the standpoint of deterrence was $50,000,000 (which might represent 10% of the market value of the defendant’s common stock—i.e., the market value of all outstanding shares being $500,000,000). Such a fine would work a substantial hardship on employees, creditors, and indeed the community surrounding the convicted corporation. But if instead of a cash fine, the court were to require the issuance by the corporation to a victim compensation fund of new securities equal to 10% of its common stock, the penalty would still be the equivalent of $50,000,000. Roughly speaking, this issuance would be the equivalent of a 10% stock dividend—except that the shares would all be directed to a single recipient, the state’s crime victim compensation fund. The fund could then hold or liquidate such shares under traditional fiduciary principles applicable to investment managers.

On whom would this penalty fall? First of all, it is less likely to be passed on to the consumer or to have significant effect on the employees of the corporation. To both of these classes, the penalty simply subdivides the corporate pie into more and smaller

8. Even if the corporation (in an imperfectly competitive product market) sought to raise prices, the gain would flow through to both the old and new stockholder classes. Thus, the old stockholders could not pass on the penalty to this degree, and thereby they have more of an incentive to discipline management.
pieces. Thus, if there were 9,000,000 shares outstanding, 1,000,000 shares would be issued by the corporation to the crime victim compensation fund, and, in theory, the price per share would adjust downward by 10% (much as in the case of a stock split). Similarly, there would be little negative effect on creditors since corporate insolvency cannot be caused by sub-dividing the net worth of the corporation into smaller units. Nor would the corporation's debt-equity be made more risky. To a considerable extent, then, the "spill-over" of deterrence has been confined so that it does not reach the innocent. In turn, judicial reluctance to impose necessary penalties may diminish. An equally important reason for predicting that the nullification phenomenon would be reduced is that the penalty would now achieve compensatory as well as deterrent objectives: the court would have an incentive to fill the coffers of the state's victim compensation fund which it does not have in the case of the fines.

The costs of deterrence are still, of course, visited upon the stockholder. But, even as to this class, there is a difference between the corporation being fined $50,000,000 in cash and the dilutive issuance of $50,000,000 in additional common stock. The difference is basically that the latter penalty does not raise the risk of bankruptcy. In contrast, the levying of $50,000,000 cash fine may deplete the corporation's cash reserves such that it cannot (1) weather a downturn in the business cycle, (2) meet future obligations as they mature, or (3) obtain additional debt or equity financing. Thus, even as to the stockholders, there is a marginal degree of superiority associated with fines levied in securities over fines levied in cash. Greater protection than this cannot be directly given the stockholders without weakening their incentive to discipline managers who involve the corporation in criminal behavior.

Here, the logic of deterrence is cold and cruel: the higher the penalty visited upon the corporation, the greater will be the interest of shareholders in monitoring controls. If the penalties are low, there will be little impetus for an internal disciplinary response within the firm. This does not mean that the full cost of deterrence must rest ultimately upon the shareholders. Through the medium of the stockholder's derivative suit it can in principle (if seldom today in practice) be shifted to responsible management. Once again, the higher the penalty, the greater the incentive for injured stockholders to bring such suits to pass on the costs of deterrence—at least partially—to those who are truly culpable.

Thus, it appears that the equity fine limits the spill-over of
deterrence to one class (i.e., stockholders) and, even here, mitigates the loss by averting the prospect of corporate insolvency. But we are still left, however, with a sharp disparity between the treatment of stockholders and other non-culpable classes. Is this so unfair that a court will simply refuse to focus punishment in a fashion which is clearly inequitable? I think not. Several arguments can reasonably be made why this disparity between the treatment of stockholders and other non-culpable classes is less objectionable than it at first appears. First, unlike the consumer and the employee, stockholders typically receive the benefit of the crime (albeit indirectly). Thus, although stockholders may be innocent of wrongdoing, focusing the cost of deterrence on them in a sense cancels out the unjust enrichment they earlier received.

Second, the loss to stockholders is typically more diffused and less intense than it would be to employees. Few stockholders hold only one security, but most workers have only one job to lose; loss of investment capital is likely to be a lesser injury than loss of a means of livelihood. Third, stockholders have, at least potentially, greater control over their fate. Those who are risk-averse can invest in “safer” securities which are less likely to be vulnerable to high criminal penalties, and stockholders can pressure management for more thorough auditing and monitoring safeguards.

Does this mean that nullification of punitive penalties will cease to be a barrier to effective law enforcement? By no means! But these factors should mitigate the intensity of the phenomenon. Let us turn next to my two other initial premises: (1) the “Doomsday” premise that the penalty must substantially exceed the gain, and (2) the “Frolic and Detour” premise that managers act out of motivations not identical with those of the general corporate welfare.

Taking the last first, there is an important consequence to the use of equity securities as the medium of payment. Simply put, it creates a large block of marketable securities which can be sold intact to the highest bidder by the trustee who manages the victim compensation fund. This in turn raises a substantial possibility that the defendant corporation will become the target of a corporate suitor who will see such a block as the necessary toehold acquisition from which to launch a tender offer or other campaign seeking control of the defendant corporation.

What is the significance of this? To the extent that involvement in criminal behavior makes the corporation more vulnerable to a hostile takeover, we create a sanction—which is virtually
costless to society—by which to deter the corporate manager whose self-interest is not aligned with that of his firm. Empirically, there is much evidence that corporate managers fear a change in corporate control. Such a transition invades their sphere of managerial autonomy, brings uncertainty, and may result in their ouster from office. As a practical matter, senior corporate management can almost never be ousted from office by public shareholders who are widely scattered and disorganized; thus, proxy fights are today rare and almost always fail.

The one clear and present danger to an incumbent management is that another corporation will assemble a block of its stock sufficient to give it control. Put simply, to a senior management which sees the corporation as its toy, the existence of a sizeable block of securities is distressing. In this light, consider again my earlier metaphor: the Sumo wrestler and the judo artist are about to be placed on the auction block by the victim compensation fund. Here we have a sanction which uses an existing internal force within the corporation to achieve deterrence, rather than seeking simply to bludgeon the corporation into submission.

Of my three original premises, one remains: the “Doomsday” premise. How would it be affected? My suggestion is that it will be possible to impose higher penalties when the medium of payment is securities than if it is cash. First, courts will be less reluctant to impose high penalties if a clear compensatory objective is achieved (i.e., the crime victim compensation fund is the beneficiary). This, of course, could also be achieved with cash fines. But second, and more importantly, a ceiling must be recognized on our ability to deter the corporation: it cannot give more than it has. In both cases, an outer limit is set by the market value of the corporation, but, in the case of the cash fines, a more confining interior limit exists: the sum of the corporation’s available liquid assets plus the amount it can borrow. This amount will often be significantly less than the company’s total market value. In economic theory, the value of the corporation is the value of its expected future earnings discounted to present value at a discount rate which reflects the time value of money, the riskiness of the expected return, and the possibility of earnings growth. Put more simply, a young company with excellent prospects may still have a low book value, limited cash resources, and little borrowing capacity with financial institutions. Yet, because of its expected future growth, it could be trad-

9. A company characterized by high growth prospects and by high risk would
ing on the stock exchange at a price-earnings ratio of 30 to 1 (e.g., IBM in the 1950's, Xerox in the 1960's, or Digital Equipment in the 1970's). Even in a less extreme case, the majority of public corporations trade above book value, and few would be able to pay a fine equal to even 40% of book value without liquidating. In short, corporations have a market value based on their discounted future earnings, but cannot pay a fine from future earnings unless securities are the medium of payment.

However, were we to impose equity fines, there is in principle no limit short of the total market value of the corporation. For example, if 1,000,000 shares were outstanding and were valued at $10,000,000 (i.e., $10 per share), we could impose a $9,000,000 fine by requiring the issuance of 9,000,000 shares. In essence, corporate capital punishment is possible in this context and without the inevitable loss in value that liquidation or insolvency reorganization involve (because the “going concern” value of the firm exceeds its liquidation value).

Finally, there are arguably some other serendipitous benefits that this approach carries with it. First, the concept of an equity fine naturally integrates with that of a public interest director for delinquent corporations. This idea, which has been much stressed by some reformers, may automatically result from a significant issuance of shares. If a substantial block of stock is issued to a single holder (i.e., the victim compensation fund) which may hold these securities indefinitely, then traditionally such a holder would be entitled to representation on the corporation's board. As a result, by issuing, say, 10% of the corporation's shares to a victim compensation fund, the trustee of the fund becomes a “public interest” director of the board. Even if this is not the automatic result, it might be judicially imposed; in a series of recent civil cases—both consent decrees and litigated decisions—the SEC has obtained the appointment of a watchdog director as an equitable remedy. Whether this particular remedy (i.e., the public interest director) is of value is debatable. Empirical studies of public interest directors have not found them to have behaved much differently from other directors. But the difference here would be the constituency behind the director: those injured by the corporation's past behavior be unattractive to risk-averse lending institutions, but still potentially very attractive to the less risk-averse equity securities market. Thus, although a corporation can borrow to pay a fine, its borrowing capacity will be significantly below its discounted market value on a future earnings basis.
become potentially vocal stockholders.

A second and more important corollary of the equity fine as a remedy would be its effect on the stock market. In an efficient capital market, stock prices discount future possibilities as well as past information. Thus, because the equity fine could be greater than the cash fine, the stock market would begin to discount the securities of these companies, though vulnerable to future criminal prosecutions. In effect, there would be a unique kind of general deterrent effect: punishment would, to a degree, precede the crime; companies perceived as operating in risky legal areas would see their stock values decline. To compensate, corporate managers would have an incentive to play the role of Caesar's wife, forever above the suspicions of the crowd. All this leads to an ironic result: for years, the field of securities law has seen a debate between the proponents of a doctrine called ethical materiality (which essentially holds that the corporation's disclosure obligation should encompass all matters bearing on the integrity and social performance of the corporation and its officers) and those of a more "tough-minded" persuasion who have argued that in fact shareholders today pay little heed to such data. The case for the latter school is strong. Empirical data seems to show that the stock market price of corporations which were identified as involved in illegal activity has not declined following the announcement, thus suggesting that the latter school is right. But if penalties are made severe enough, this gap between the ethical investor as a normative concept and the economic investor as an empirical reality closes. The hard-boiled investor becomes interested in the corporation's posture vis-à-vis such topics as the environment, design safety, or discrimination because he cannot afford not to be concerned.

Cure-alls are relatively rare, and some caveats now need to be expressed:

(1) The degree to which equity fines will deter corporate managers, as distinct from their corporations, would vary considerably, depending on the dispersion of the stock ownership of the particular corporation (e.g., is it a potential takeover target or is it relatively invulnerable). A family-owned corporation, such as Ford, or a giant such as General Motors, obviously does not live in fear of a hostile takeover. Still, because the equity fine increases the total shares outstanding (i.e., it enlarges the denominator as well as altering the numerator), no corporation is totally safe. Even in a family-held company—as in King Lear's Kingdom—dissension and
factionalism are possible. If a sizeable block does not threaten a change in control, it still invades managerial autonomy by giving a new holder a claim to representation on the board and a toehold by which to pursue control in the long run.

(2) In some areas of the law—the best example being antitrust—adequate deterrence may already exist because of the existence of civil treble damage actions. Here, the equity fine would serve principally to minimize the spill-over, and even this advantage would be lost if the fine were to be followed by a punitive cash award. In these areas, greater rationalization of civil and criminal penalties is needed, but the remedy here proposed is not meant to be mandatory. Rather, it would be an alternative and supplementary penalty which could be combined with cash fines and civil damages.

(3) The equity fine may inhibit (but does not destroy) the ability of the corporation to raise capital through the issuance of equity securities. Both because of the dilutive effect of such a fine and because of the overhang effect on the market which a marketable block in the hands of a trustee creates, a subsequent equity offering becomes less attractive to the original stockholders. However, the empirical evidence is that most public corporations have seldom recently issued equity securities to raise funds (they prefer to use retained earnings or debt financings for this purpose for a variety of reasons, including particularly the tax effect of the interest deduction). Equity issuances are chiefly made today (a) to effect the acquisition of other companies (again, for tax reasons), and (b) to obtain sufficient stockholder distribution to qualify for a stock exchange listing. Although legitimate, neither of these objectives deserves the same societal deference as does the "spill-over" problem, and thus the social cost of the equity fine is smaller by at least an order of magnitude.

ADVERSE PUBLICITY AS A CRIMINAL SANCTION

We have been discussing a sanction which has little chance of political adoption. My justification for such an extended examination is that the equity fine supplies a paradigm of the optimal sanction for corporate misbehavior. Deterrence is achieved at a relatively cheap cost in terms of the externalities that punishment causes; not only is the corporation, as an entity, deterred but so is

---

10. As Ford's recent history shows (i.e., the lawsuit by Benson Ford against Henry Ford).
the individual decisionmaker as well, to the extent that his motivations and cost-benefit calculations differ from those of his firm.

But to suggest that the equity fine supplies a paradigm implies that it is not unique. Are there other examples of sanctions that minimize the spill-over of deterrence? I shall next discuss two: (1) the use of adverse publicity, and (2) the manipulation of the collateral estoppel effect of a criminal conviction.

Let us return to the Ford Pinto case. Ford is reported to have spent over $1,000,000 on its legal defense; yet the maximum fine could not have exceeded $30,000. Obviously, something besides the potential fine motivated Ford’s vigorous legal defense.

Against this backdrop, it is not surprising that a number of legal commentators have advocated the use of a formal publicity sanction. In particular, Sanford Kadish of Berkeley, Ernest Gellhorn of Virginia and Professor Morris’ countryman, Brent Fisse, have explored this topic in some depth. Professor Fisse, for instance, shows that publicity sanctions were common to the English criminal law of earlier centuries when, for example, the names of merchants who sold adulterated products were publicly posted.\(^\text{1}\)

Professor Fisse suggests that the government publish a corporation journal describing the offenses of convicted corporations. Here, reform begins to sound mechanical and pedestrian. Publicity is not that easily managed; rather, it is a loose canon. Almost certainly, such post-conviction publicity would be superfluous in the Pinto cases where even an acquittal will not save Ford from some damage to its reputation and substantial injury to its sales of new Pintos. Conversely, a corporation journal may have little impact where the crime is a regulatory one having little inherent blameworthiness (e.g., a criminal violation of the margin rules of the Securities Exchange Act of 1934).

It is both the strength and weakness of publicity as a sanction that it grows naturally out of the criminal process. The criminal process has an inherent theatricality. Uniquely, it attracts media coverage because it provides multiple scenes of high drama: the indictment, the opening and closing statements to the jury, the judge’s charge, and, best of all, the wait for the verdict. But our ability to manage that theatricality is limited: the public responds with outrage when it is struck by crimes that threaten its health or safety, but it tends to be lethargic and even cynical in its reactions.

---

\(^{1}\) See Fisse, The Use of Publicity As A Criminal Sanction Against Business Corporations, 8 MELBOURNE UNIVERSITY L. REV. 107 (1971).
to crimes that are merely regulatory in character. This is the lesson that the muckrakers learned to their dismay 70 years ago: the public was shocked to learn that the food it ate was unfit for human consumption, but was bored by tales of corruption in high places and uninterested in institutional reform. Thus, publicity will attach to those crimes the public fears, but less so to those that may stand in the greatest need of additional deterrence. Before turning to a counter-perspective, let me summarize, then, the problems that lie in any attempt to use publicity as an independent sanction. First, the government has trouble being persuasive. Rarely is it pithy; never can it speak in the catchy slogans with which Madison Avenue mesmerizes us. The soporific quality of governmental prose matters little when it is addressed (as it usually is) to lobbyists, bureaucrats, and lawyers. But to be effective, a publicity sanction must make the public pay attention. An ethical dilemma thus arises here: publicity requires some oversimplification. The message must be simple and catchy—even if a price must be paid in terms of its accuracy. Hopefully, there is something ethically troubling to one about the government directly engaging in so dubious an endeavor as attempting to compete with the Madison Avenue advertising agencies.

A second and related problem is that of sensory overload: the communication channels of our society are already inundated with criticisms of corporations. In the language of the communications theorists, there is too much noise in the channels for any message to be heard with clarity. Simply everyone has an unkind word for corporations today: editorialists, television commentators, and politicians facing re-election. This is said not in defense of corporations, but to point out that the currency is being devalued. Gresham's Law states that bad money drives out the good, and, in the same vein, weak criticism tends to rob accurate censure of its expressive force. The criminal conviction of the corporation is a unique event, but it loses its special force when the public constantly receives an implicit message that all corporations are corrupt or amoral.

Third, there is the problem of counter-publicity. As the Mobil Oil advertisements should remind us, the corporation can fight back—and effectively. This may make the cost effectiveness of governmental publicity less certain than first it may have seemed.

Finally, publicity as a criminal sanction is unfocused in its aim. If its intent is to inflict a loss on the corporation, we run once again into the "Spill-Over" problem since the corporation is not
the ultimate cost-bearer. By stigmatizing the corporation, we may injure workers and other innocent parties as much as if we fined the corporation or, if we do not, the remedy misfires. Frankly, if we are willing to accept these costs, it will seem easier and more direct to rely on fines. If instead the intent of a publicity sanction is to deter corporate officials on the assumption that they respond to a distinct set of costs and benefits which is different from that of the corporation, then it again may be simpler to proceed more directly by prosecuting the individual, rather than the corporation, because then the stigmatization threat is more immediate and personal. Moreover, there is a very large and much debated issue in the literature on white collar crime as to whether one can stigmatize the corporation for those crimes that are essentially "regulatory" in nature and not intrinsically blameworthy (i.e., the Robinson-Patman Act).\(^1\)

From the foregoing, it may sound that I have come more to bury publicity as a criminal sanction than to praise it. But this is not the case. When it is properly focused, I believe we can use publicity to increase the deterrent threat of a corporate conviction. To explain this, let me begin with a seemingly unrelated empirical study. In an elaborate statistical study, two Carnegie-Mellon criminologists—Alfred Blumstein and Daniel Nagin—sought to measure the relative deterrent impacts of stigmatization (that is, conviction without a sanction) and imprisonment in the case of one particular type of middle class crime.\(^3\) They concluded that the former much outweighed the latter: the middle class criminal they studied was frightened chiefly by the threat of conviction and only incrementally by the risk of imprisonment. The particular crime they studied was draft evasion. Obviously, this is different in some respects from price-fixing, but it is also similar in that it is a deliberate rational act made with a view to the possible consequences. Both such types of offenders believe they are not "true" criminals, but see themselves (with differing perceptiveness) as victims of governmental harassment. As a result, Blumstein and Nagin's finding about the deterrent effect of stigma has a generalized relevance to middle class crime (as indeed they asserted). This finding should remind us that the real issue is not the appeal of adverse publicity to the public audience (i.e., its "newsworthiness"), but

---

rather its deterrent effect on the decisionmaker. Potentially, the former can be low at the same time as the latter is high.

As the skeptic will immediately note, however, Blumstein and Nagin were focusing on the case where the individual himself is convicted, while in our case, where the corporation is convicted, the individual receives at most a diluted, pro-rata share of the stigma. But here, at least, is a variable that we can sensibly alter by seeking to focus the publicity less on the corporation and more on the culpable officials within the firm.

Let me spell out my policy assumptions more clearly:

(1) The government is not itself a terribly good propagandist.

(2) Some forms of corporate crime are newsworthy; some less so. Thus, we cannot rely on sufficient publicity surrounding the mere fact of the corporation’s conviction so as to enhance significantly the severity of the penalty.

(3) Even if we could injure the corporation by adverse publicity in a manner equivalent to a fine, the loss would once again fall on the wrong parties (i.e., the “Spill-Over” problem).

(4) But if the publicity following a corporate conviction could be focused on the individual manager who was responsible, then spill-over would be minimized, deterrence would be enhanced, and the incongruence between the motivations of the manager and the firm would be better addressed. Thus, publicity as a sanction should be chiefly framed with a view to addressing what I have earlier termed the “Frolic and Detour” problem.

Still remaining, however, is the objection that the government is relatively poor at handling publicity. Here, my answer is that what the government cannot do directly, it can encourage the marketplace to do by furnishing it with the raw materials at a low cost.

Let me explain this cryptic remark by beginning with an empirical observation. Most major corporate scandals of the last two decades—from the electrical equipment conspiracy of the 1950’s to the illegal payments cases of the 1970’s—have been followed by a series of books: sometimes mindless exposés, sometimes careful studies. Generally, they have focused on the behavior of the managers within the corporation.

There is something about internal decisionmaking within the corporation, particularly when it leads to crime, that seems to fascinate the investigative journalist—even when the crimes involved are essentially “regulatory.” Watergate, with its emphasis on cover-ups, has probably intensified this interest. This suggests that the government, rather than seeking to disseminate the publicity
itself, should serve instead as research assistant to the investigative journalist. This does not present the government with the morally ambiguous task of having to choose between effective sensationalism and turgid accuracy. Nor does it require the judiciary to learn the skills of the public relations field.

What could the judiciary do to implement such a sanction? First, it would serve as an archivist. In a Pinto-type case, a great deal of potential evidence is assembled. Often, the court declines to admit much of it into evidence for a variety of good reasons. Sometimes the evidence that is, in fact, heard or admitted is not adequately preserved. Other times evidence is not used for prudential reasons—such as possible attacks on cross-examinations. All such information—whether admissible or inadmissible—could be made accessible and available to qualified journalists after the trial.

Second, the traditional pre-sentence report needs to be revised for the corporate offender. Rather than relying upon the traditional probation officer (whose experience with corporate affairs is, to say the least, minimal), the court should appoint a qualified corporate attorney as a special pre-sentence officer to prepare a report on the factual circumstances of the crime and the internal factors within the corporation that contributed to its occurrence.14

Such a special pre-sentence officer might interview relevant corporate officials to determine their individual involvement. My model here is the highly regarded study prepared by John J. McCloy of the New York Bar, of Gulf Oil's involvement in Watergate and illegal payments. Mr. McCloy, a well-known statesman and Presidential adviser, was appointed special counsel to the Gulf Board at the behest of the Securities and Exchange Commission. Eventually, his report led to the resignation of some senior Gulf officials and the institution of internal reforms.

Put simply, the criminal process can learn from the SEC experience with illegal payments cases and should generalize that experience to the broader range of cases it confronts. Indeed, as part of its sentence, the corporation can be placed on probation and ordered to conduct an adequate self-study as a condition of probation. Here the SEC experience is particularly relevant. From its illegal payment cases, one generalization about corporate self-scru-

14. Typically, the pre-sentence report is a confidential report to the court. Either this could be changed in the case of the corporation, or the report's preparation could instead be made a condition of probation.
tiny stands out: the adequacy, and indeed integrity, of the self-study report depends primarily on whether the report is conducted by an independent special counsel or only by the corporation itself using its existing attorneys. When the corporation investigates itself, few smoking guns are discovered.15

Properly done, corporate self-studies conducted by disinterested attorneys perform a number of functions: (1) they focus the adverse publicity on the culpable officials, or the sector of the company that had inadequate internal controls, rather than simply tainting the corporate name generally; (2) they trigger an internal disciplinary response as the corporation may find it too embarrassing to continue certain officials in office; (3) they alert plaintiffs to bring derivative suits, thus integrating civil and criminal remedies; and (4) they supply the raw materials for the investigative journalist who wishes to probe deeper.

All of this can be done without sensationalism. But there is a role for sensationalism. The investigative journalist can himself be a source of deterrence. I do not claim so much that he will deter the commission of the original crime (although this is conceivable) as I do that his potential presence will deter an organizational conspiracy from attempting to cover it up. This is the great success of investigative journalism: it can pierce cosmetic defenses far better than the legal process and can do so with such effectiveness as to dissuade even the attempt at a cover-up. Thus, once again, we are presented with my earlier analogy of the judo artist who re-directs force rather than simply out-muscling his opponent. If necessary,

15. For an overview of this "literature of self-scrutiny" which emerged from the illegal payments controversy see DeMott, Reweaving the Corporate Veil: Management Structure and the Control of Corporate Information, 41 LAW AND CONTEMP. PROB. 189 (1977). In his rebuttal to this article, Mr. Crane stresses the alleged civil liberties infringements that my suggestion would produce. Two points must be made in reply. (1) Current law—namely § 21(a) of the Securities Exchange Act of 1934—permits the SEC to issue a stigmatizing public report without any judicial finding at all; my proposal is more modest in that publicity follows the conviction rather than replaces it; the existence of a judicial finding as a precondition is an important civil libertarian safeguard; (2) information about the corporation is a property right of the corporation, not of the individual manager, and the individual officer has little recognized constitutional interest in business records. See Bellis v. United States, 417 U.S. 85 (1974); Couch v. United States, 409 U.S. 322 (1973); Andresen v. Maryland, 427 U.S. 463 (1976). Nor is the individual manager facing any criminal penalty since the prosecutor will have probably earlier decided to prosecute only the corporation. Obviously, the public's first amendment "right to know" also supplies a constitutional counterweight to which Mr. Crane gives little weight.
we could further assist this process by giving the journalist special powers in the case of a convicted corporation—for example, a journalistic subpoena which the sentencing court could enforce if reasonable.

INTEGRATING CRIMINAL AND CIVIL PENALTIES

It is time now to turn to the last and, as a practical matter, probably the most important source of deterrence for corporate misbehavior: the private plaintiff. Can we harness him as a private attorney general? The issue divides into two parts. First, how can this be achieved? Second, what are the costs of so doing?

The importance of the deterrent threat generated by the private plaintiff seems easily demonstrated. The largest fine ever imposed by the FTC was $500,000. Yet, some reports have placed the likely total settlements in the paper box board price-fixing conspiracy to be over $1,000,000,000. The electrical equipment price-fixing conspiracy resulted in the defendants paying roughly $600,000,000 to settle private litigation (but the largest single fine in that case was only $437,500—paid by General Electric). This phenomenon is not limited to the antitrust context. The Nuclear Regulatory Commission fined the operators of the Three Mile Island facility only $155,000 in a case of repeated violations, but, if civil litigation could be settled at tenfold this amount, I suspect strongly that such a settlement would be swiftly agreed to by the defendants.

But the deterrent threat of private civil litigation is far from a generalized phenomenon. Where it is effective, two conditions are generally present: (1) a class action is possible (with the result that the plaintiff's attorney is well compensated), and (2) the criminal conviction is given some collateral effect. Let us look at each of these required conditions in turn. In those cases where a class action is predictable (e.g., antitrust, securities, and mass disaster cases), civil damages both substantially enhance the financial threat of criminal penalties and raise the risk of apprehension by giving the private attorney a handsome recovery which supplies the incentive for him to invest substantial time and money in pursuit of a favorable judgment. In other contexts, the class action is less likely to be as useful a deterrent because there are too many issues which are not common to all the members. For example, if the victims of twenty different Pinto explosions were to pursue Ford civilly, there would be too many issues unique to each crash (e.g., proximate cause, contributory negligence, among others) for the class action to be effective.
There is an important generalization underlying this observation that needs to be better recognized. In any legal dispute, the plaintiff needs to prove a certain number of distinct issues before he may recover. In a tort case, typically these include: (1) the existence of a legal duty owed to him, (2) negligent behavior by the defendant, (3) proximate causation, and (4) damages. The higher the percentage of these predicate elements which can be proven in a class action, the greater is the deterrent threat that civil litigation poses to the defendant. In those cases where a high percentage may be so proven, the availability of the class action is probably a more important deterrent than the existence of a treble damages recovery. But both the context of antitrust law and securities law are relatively unique in this regard: all the critical issues can be established in the class action. The same is also true in mass disaster cases (e.g., airplane crashes or possible nuclear accidents). But it is clearly not as true in a Pinto-type case. Therefore, the case is even stronger in these latter cases for legislating a treble damages formula as a partial substitute for the class action.

Let us now turn to my second variable: the res judicata or issue preclusion variable. Interestingly, the collateral effect of a criminal conviction is today expressly established in the two contexts where civil litigation is usually agreed to be the most effective in achieving general deterrence: (1) the antitrust laws, and (2) the securities laws. In the former context, the Clayton Act expressly makes a criminal conviction “prima facie” evidence in the subsequent civil action for damages, and in the latter context, the Supreme Court’s decision last year in Parklane Hosiery v. Shore entitles a civil plaintiff to preclude a defendant from re-litigating issues which were determined in a prior SEC civil injunctive action. This acceptance by the Court of the constitutionality of the offensive use by a non-party of collateral estoppel opens up a hori-

16. Probably, the largest criminal fine on record was the $13,200,000 fine imposed in 1977 on Allied Chemical in connection with the Kepone case. I suspect, however, that more was achieved by the SEC consent decree requiring it to install adequate monitoring and warning controls.

17. In the most common securities law actions, the victim of a securities fraud does not have to prove his actual reliance on the misleading statement or material omission. See Mills v. Electric Auto-Lite Company, 396 U.S. 375 (1970). Where this is true, the deterrent effect of the securities law class action suit is greatly enhanced.

18. 439 U.S. 322 (1979) (permitting private plaintiff to invoke collateral estoppel as to matters decided adversely to defendant in prior SEC civil injunctive suit, notwithstanding lack of mutuality).
zon of possibilities to which the legislature should respond. I will return to this theme shortly, but first let us consider the social costs of both these reforms.

Given that the class action does not effectively enhance the criminal penalty in all situations, we could, as suggested, authorize a private treble damages recovery for all victims of corporate offenses. This would provide a substitute incentive to the private enforcer which might approach that which the class action now provides. Recently, several states, most notably Iowa, have legislatively adopted such a treble damages recovery by private parties against corporate offenders.¹⁹

But there is a very serious potential social cost here. If we simply authorize a direct private action against the corporation for a multiple of the actual damages suffered by the private enforcer, we lose the advantages of prosecutorial discretion. As the economists are fond of saying, a "misinformation effect" results in such a case when a private party is given a strong incentive to establish the fact of violation.²⁰ Put simply, private plaintiffs are likely to misrepresent that an injury has occurred to them when in fact it has not (as in turn defendants are likely to misrepresent their innocence). This danger is greatest where the substantive command of the statute is relatively vague, as in the securities and antitrust field. In combination, high penalties and private actions have a tendency to stretch and distort the law. Where the public enforcer is interested in a rational body of law, the private enforcer is not. As the recent history of securities law probably shows, the result of such a union of potentially high damages and private enforcement can be extortionate settlements.

If so, how then should we combine public and private enforcement so as to reinforce each other? I will attempt here only some observations which are in the nature of guidelines, not ironclad laws:

1) Treble damages formulae (and similar punitive measures) should be used primarily where the class action is either unavailable or unlikely to be an effective deterrent. From a deterrence perspective, the class action and the multiple damages formulae are essentially substitutes for each other and should not be automatically combined.

(2) Where the actionable loss greatly exceeds the likely gain to the corporation, the case for a multiple recovery is correspondingly weakened. Conversely, to the extent the crime is concealable, the justification for granting private plaintiffs treble damages, or similar recovery is strengthened.

(3) Where the criminal prohibition is necessarily vague in its potential applications (as, for example, the securities laws are in their dependence on the critical concept of materiality), public enforcement should be preferred in order to preserve prosecutorial discretion. In such areas, the private plaintiff is best consigned to a "piggyback" role: that is, he should be permitted to bring an action only when the public enforcer has established the fact of a violation. Where necessary to achieve deterrence, however, the private plaintiff could still be given a treble damages recovery (even though he has done little creative work and has instead "piggybacked" to a judgment). But the more equitable path to adequate deterrence in such a context would be the equity fine.

(4) The case for private enforcement combined with a multiple-of-damages recovery is strongest in those areas where the criminal prohibition is not vague, but the crime is concealable (i.e., certain forms of illegal disposal of toxic wastes or, perhaps, price-fixing). This allocation of roles between the public and private enforcer answers the ancient argument that public prosecutorial resources are limited and therefore require the assistance of private attorneys general. This argument may be true, but it does not inhibit society from defining more carefully how the supplemental assistance of the profit-motivated private attorney general should be directed.

In sum, such a restricted role for private enforcement preserves prosecutorial discretion, but also retains the deterrent effect of the private enforcer. At this point, it might reasonably be asked: Why is this proposed integration of private and public enforcement superior to exemplary fines, which might also be levied in an amount roughly equal to the private damages recovery? Here, we must return to my original point about the tendency toward nullification of severely punitive penalties. Experience with private antitrust enforcement suggests that there is not the same tendency when the private enforcer seeks treble damages. Why not? First, the objective is compensation, rather than simply deterrence. It seems to be that severe penalties can be imposed by our legal system only when they serve to compensate someone. Prosecutors do not have the same interest as plaintiffs in obtaining a punitive
award; their success is measured by their win/lose ratio, rather than by the severity of the sentence. Second, in the case of private enforcement, there is no single decisionmaker who is in the same position as the sentencing judge; hence, no one judge can mitigate the penalty once there is a conviction. When several courts hear the subsequent private antitrust actions, no individual court sees the total effect of the liability being imposed on the corporation. Alternatively, the courts hearing the subsequent civil actions may feel they lack discretion where the fact of criminal liability has earlier been established by a different court; nor may they feel the same personal responsibility for the social consequences of a decision which was, in effect, earlier made by the criminal court. In turn, the criminal court never had to focus on these consequences when it was only imposing a small fine since it did not have the civil litigation against the offender before it.

Even where the same court hears the subsequent civil actions, it may feel bound by its earlier decision in the criminal case. Possibly, too, courts act more liberally when awarding damages to "flesh and blood" plaintiffs than when awarding fines to the faceless state. Finally, the judiciary may have very little role to play in determining the size of the civil recovery since the parties will generally settle the litigation at some discount from the full treble damages recovery. But, whatever the reason, this combination of public enforcement by the state through a criminal prosecution followed by private enforcement through civil litigation seems to reduce the nullification problem.

What it does not avoid, however, is the "Spill-Over" problem. No matter who is doing the enforcing, the fact remains that the convicted corporation is not the ultimate cost-bearer. Thus, has our analysis really been advanced simply by finding a path around the nullification hurdle?

Here, we arrive at the critical juncture of this argument: the "Spill-Over" problem arises only when liabilities are imposed, not when they are threatened. In plain language, it is not strictly necessary that the private plaintiff receive his treble damages recovery for the potential existence of such a recovery to have the desired deterrent effect. As long as the threat is credible, it can accomplish its purpose.

How should we short-circuit the private enforcer so that socially counter-productive liabilities are not necessarily imposed? I would advocate a more sophisticated use by prosecutors and courts of the *nolo contendere* plea. The *nolo* plea has fallen into disfa-
CORPORATE CRIMINAL SANCTIONS

vor—and understandably so. Rule 11(b) of the Federal Rules of Criminal Procedure now requires the court to hear the views of the prosecutor before accepting such a plea, and the Department of Justice’s Internal Policy Manual for United States Attorneys instructs all U.S. attorneys to resist such a plea, absent special approval from the Department. Although the federal courts still tend to ignore this position in antitrust cases, nolo pleas are today only infrequently accepted in other cases. Yet it is precisely in the case of the corporation that plea bargaining makes the most sense, since such prosecutions are costly to the state and there is little need, generally, for incapacitation.

In short, the nolo plea should be the subject of bargaining between the prosecutor and defense counsel. What might the prosecutor sensibly bargain for? Prime candidates would include the following: (1) restitution to injured victims (in effect, the injured party would receive compensation through the criminal process, but not treble damages); (2) preventative auditing and monitoring controls imposed as a condition of probation; (3) resolution of pending civil litigation, thus reducing judicial delay and unburdening the court; and (4) a suspended fine, which would be imposed if conditions of probation were violated or another conviction ensured within a defined period.

In this light, the role of the private enforcer is essentially to serve as the bludgeon with which the prosecutor can threaten the defendant. To be sure, the acceptance of the nolo plea would not prevent private litigation, but it would raise the odds by denying any collateral estoppel effect to the criminal conviction.

To implement this integration of private and public enforcement, two legislative revisions are necessary: (1) a treble damages action by private plaintiffs which is triggered by the criminal conviction (and only by the criminal conviction);22 and (2) statutory

21. For an interesting recent example of such bargaining, see Patterson v. Stovall, 528 F.2d 108 (7th Cir. 1976) (companion civil case to criminal case in which the prosecution traded a nolo plea for restitution to victims of fraud).

22. The Iowa statute is an example of this. See IOWA CORRECTIONS CODE, ch. 909.4 (1979) (giving injured victim a treble damages action against a corporation convicted of a felony for damages to victim caused by the crime). I should explain here that I do not mean this suggestion to deny a private treble damages remedy to antitrust plaintiffs. I do accept the private attorney general which Mr. Crane stresses in his rebuttal as it applies to this specific context, where the evil is fairly well defined (typically price-fixing) and where a well-established plaintiff’s bar already exists and has been relied upon. What I am suggesting is that we cannot afford to generalize this private remedy to other contexts (e.g., environmental and
clarification of the collateral estoppel effect of a criminal conviction. The first provision raises the incentive for plea bargaining and makes a settlement attractive under which the defendant bartered restitution in return for the nolo plea.

The second provision may seem surprising since it is the conventional wisdom among lawyers that a criminal conviction does indeed have the collateral effect of conclusively establishing the facts alleged in the indictment as to the charges that resulted in conviction. Strangely, however, this is not the law in most states. As Professor Vestal demonstrates in his treatise, it is only in a handful of jurisdictions that a third party plaintiff may use the criminal conviction for purposes of offensive collateral estoppel so as to deny the defendant the opportunity to relitigate civilly the issues on which he was criminally convicted. Traditionally, the obstacle to such use of the criminal conviction was the doctrine of mutuality: either both were bound, or neither was bound, and clearly the civil plaintiff could not be estopped by an acquittal in the criminal case (where he was not a party and where a higher standard of proof applied). But the Restatement of Judgments Secured has abandoned this doctrine, and the Supreme Court laid it to rest last year in Parklane.

In the wake of Parklane, which permitted a civil plaintiff to make offensive use of a prior civil judgment obtained by a government agency, there is little reason to deny the same collateral effect to a criminal conviction. Statutory reform is, however, important because of one aspect of Parklane. This decision substitutes toxic chemical damages, consumer fraud, false advertising) because the institution of prosecutorial discretion is too important to be sacrificed by this reliance on private enforcers, particularly in contexts where the injury is less objectively verifiable. However, because courts nullify heavy penalties, we can intelligently make use of private enforcement to reduce this barrier to effective deterrence by integrating private enforcement with the criminal conviction.


24. 439 U.S. 322 (1979) (unsuccessful defendant in civil SEC injunctive action may not seek to relitigate its liability in subsequent private civil action brought by private plaintiff, even though the consequence was to deny it a jury trial).
in place of the old mutuality doctrine the requirement that the defendant have a sufficient incentive to litigate "fully and vigorously" in the first action. The Supreme Court recognized that this incentive may not exist where the defendant faced only nominal damages in the first action. This test calls into question the sufficiency of the incentive to defend in criminal cases where the authorized fine is low (in particular, it makes it very questionable whether a collateral estoppel effect could be given to a misdemeanor conviction).

But the answer is clear because the problem is circular. If the potential collateral estoppel effect of a felony conviction were to be established by statute,\(^5\) the defendant would have notice of the possible loss and is thereby given in Parklane's phrase "every incentive to litigate fully and vigorously." Interestingly, once the criminal conviction is given such an effect, another simplification probably becomes possible: the same court could hear both the criminal case and the subsequent civil cases. Such consolidation might arguably be unfair if the law allows the offensive use of collateral estoppel, but not if the law requires it. In short, existing practices under the Multi-District Litigation Manual could be carried one step further: both civil and criminal cases could be consolidated before the same judge, and the criminal case tried first.

CONCLUSION: TOWARDS IMPLEMENTATION

The three strategies here outlined have a common denominator: like the judo wrestler and unlike his Sumo counterpart, they seek to make use of existing forces within the legal environment and the corporation's social system to achieve adequate corporate deterrence with a minimum of socially counter-productive results. Unless we follow such a course, I suspect that we will not escape Baron Thurlow's frustrated observation that the corporation has "neither a soul to damn nor pants to kick."

Before closing, one last question should be faced: do all the reforms discussed in this speech require legislative action? Or can they be at least partially implemented by the judiciary alone? Perhaps surprisingly, the answer would appear to be that courts could substantially achieve them without legislative action. A publicity sanction could, for example, be implemented by placing the corpo-

---

25. Such a statute should (and probably must) give the trial court some discretion as to whether to award a collateral estoppel effect to the prior conviction. This is the position of the Restatement Second.
ration on probation. The nolo contendere plea is already a discretionary decision given to the court. Although the equity fine is not within the inherent power of the court, there is no necessary obstacle to the court accepting such a fine when offered by the defendant as the alternative to a higher cash fine. This scenario is more realistic than it at first sounds. Frequently a single criminal transaction will violate multiple criminal statutes. When this happens, a cumulative fine can be levied equal to the maximum fine per count multiplied by the number of counts resulting in conviction. Under the pending Senate Bill (S.B. 1722) to recodify the Federal Criminal Code, the maximum fine for a corporation would be $1,000,000 per count. Thus, very high sentences are possible (particularly in pollution and environmental cases where the behavior tends to have been repetitive over an extended period of time). As a result, the irony may be that it will be the defendant, not the prosecutor, who first asks a sentencing court to consider the possibility of an equity fine. But clearly, the court could prepare the way for such an offer by imposing a high cash fine on a tentative basis and then suggesting to defense counsel that it consider developing an alternative formula that would offer equivalent deterrence.

Commentary: The Interplay Between Corporate Liability and The Liability of Corporate Officers

Norval Morris* 

There is an awareness of the increasing importance of the many difficult problems surrounding corporate liability. Therefore

27. See Patterson v. Stovall, supra note 15.

* Julius Kreeger Professor of Law and Criminology, University of Chicago, holds a law degree from the University of Melbourne, Ph.d. University of London. Professor of Law, University of Chicago, Dean of the University of Chicago Law School 1975 to 1978. Past Director of the United Nations Asia and Far East Institute. Director of the Center for Studies in Criminal Justice, 1964 to 1975.