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## Crime and the Corporation: Making the Punishment Fit the Corporation

John C. Coffee Jr.  
Columbia Law School, [jcoffee@law.columbia.edu](mailto:jcoffee@law.columbia.edu)

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# Crime and the Corporation:

## Making the Punishment Fit the Corporation

John C. Coffee, Jr.\*

*The debate over corporate criminal liability has long involved a fight between proponents who argue that corporate liability is necessary for effective deterrence and opponents who claim that it “punishes the innocent.” This Article agrees and disagrees with both sides. Corporate criminal liability could play a critical role in establishing an effective deterrent to organizational misconduct, but today it largely fails. Currently, we have a system that combines Deferred Prosecution Agreements, Non-Prosecution Agreements, and extraordinarily generous sentencing credits for compliance plans that have failed, and the result is a system that is more carrots than sticks. The evidence seems clear that corporate fines seldom affect the company’s stock price (even when they are record penalties), that companies rarely self-report their misconduct (despite legal incentives to do so), and that courts impose penalties that can be easily absorbed as a cost of doing business.*

*This analysis leads many to favor a system that focuses only on corporate executives and dispenses with the corporation as a target of the criminal law. Unfortunately, that approach has even higher costs. Although executives are deterrable, high-ranking corporate executives are much harder to identify and prosecute for a variety of reasons. In this light, the critical role of corporate criminal liability is that it gives the corporation a stronger incentive to self-report, monitor its employees, and turn in those responsible. But this requires that we extend leniency only for objective conduct that generates deterrence. A principal goal of this Article is to provide a roadmap for how we can make the punishment fit the corporation. Leniency can be used as a tool but should not be extended gratuitously.*

*To curb corporate misconduct, society has long faced a choice between either vicarious liability for executives (which is contrary to our legal tradition and would shock civil libertarians) and vicarious liability for shareholders (which has existed for over a century but is always bounded by the ceiling of limited liability). Either choice has its costs, and this Article suggests some possible alternatives.*

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\* Professor Coffee is the Adolf A. Berle Professor of Law at Columbia University Law School and Director of its Center on Corporate Governance. Professor Coffee wishes to acknowledge the valuable research assistance of Samantha Daisy, Columbia Law School '23, in the preparation of this Article. The author also benefitted from comments from his colleagues, Professor Harold Edgar and U.S. District Judge Jed Rakoff. This research was supported by the William L. Cary Memorial Fund (Professor Coffee once taught with Professor Cary and regards him as a model professor and scholar).

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Corporate criminal liability has been controversial since its inception. Given the ability of law professors to debate issues interminably, this debate will likely continue for as long as law professors do. Yet, even the doctrine’s harshest critics recognize that “corporate criminal liability is probably here to stay.”<sup>1</sup> Nonetheless, no better way exists for a criminal law scholar to establish a reputation as innovative and iconoclastic than to attack corporate criminal liability. Both the great and the not-so-great have engaged in this pastime, usually asserting that holding legal fictions criminally liable is an absurdity. For example, a major scholar of criminal law, Professor Albert Alschuler, opens his critique of corporate criminal liability by comparing it in his first sentence to “two ancient legal practices—[D]eodand (the punishment of animals and objects that have produced harm) and [F]rankpledge (the punishment of all members of a group when one member of the group has avoided apprehension for a crime).”<sup>2</sup> The implication here is that those who accept corporate criminal liability have to be prepared to accept either the Deodand or the Frankpledge. Actually, I agree—to an extent: group liability makes sense and can be structured so that it imposes non-criminal sanctions on the senior managerial team at a convicted corporation. Such a step does nothing more than what a criminal sentence does to the corporation’s shareholders, and it is needed because the corporation’s senior

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1. Albert W. Alschuler, *Two Ways to Think About the Punishment of Corporations*, 46 AM. CRIM. L. REV. 1359, 1372 (2009). Corporate criminal liability dates back at least to the late 1700s in England (and possibly even earlier), thus showing that it has persisted. For a short review of this history, see John C. Coffee, Jr., *Corporate Criminal Responsibility*, in 1 ENCYCLOPEDIA OF CRIME AND JUSTICE 253 (Sanford H. Kadish ed., 1983).

2. Alschuler, *supra* note 1, at 1359.

managers are both the least deterred constituency and the one that can best monitor and modify corporate behavior.

Most critics assert in common that corporate criminal liability “punishes the innocent.”<sup>3</sup> But their specific criticisms then subdivide: The earlier and larger group objects that imposing criminal liability on the corporation is inconsistent with the fundamental precepts of criminal law, particularly its emphasis on intent and mens rea. In contrast to this first group that wants to debate the philosophy of the criminal law, a second—and more recent—group has framed arguments that are largely economic in character: imposing harsh penalties on the corporation is counterproductive, they argue, because it is likely to result in lesser monitoring and lower investment in corporate internal compliance efforts (in part, because discovering and reporting a crime becomes far more costly).<sup>4</sup>

This brief Article will leave the “philosophical” objections to corporate criminal liability to others (who have already debunked many of the standard objections<sup>5</sup>) and instead focus on the more empirical critiques of the economists. Generally, the debate has been between those who believe the corporation is already adequately deterred (or even excessively deterred) and those (including this author) who doubt this. In this light, this Article cannot accept the view that the corporation is only a legal fiction. Public corporations share three critical characteristics: (i) they are elaborate informational networks in which decision-making is shared within a decentralized management team; (ii) they can (and do) suffer reputational loss that often exceeds the cash fines that have been imposed to date; and (iii) they trade in public markets where their share price may be subjected to economic penalties that can be better designed to deter than our existing system of cash fines. These characteristics should shape our search for the optimal corporate penalty. All recognize that the corporate entity is not the ultimate cost bearer, but few have focused on the possibility that senior managers may make better cost bearers than shareholders.

Critiques of corporate criminal liability tend to rely on a misdrawn map of the incentives of the participants in corporate governance. In particular, the following assumptions need to be re-examined and restated more accurately:

Criminal law, it is asserted, imposes far harsher sanctions than the civil law. Because the penalties are greater, it is unjust for the criminal to follow the civil law’s norm of respondeat superior (which makes the principal liable for the misconduct of its agents).

Imposing harsh penalties on the corporation punishes the “innocent” and is indefensible because the stakeholders in corporate governance are either ignorant of the misconduct or too dispersed and powerless to prevent it.

Overdeterrence is a real danger and is best addressed by giving corporations a

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3. *Id.*

4. See generally Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833 (1994); Assaf Hamdani & Alon Klement, *Corporate Crime and Deterrence*, 61 STAN. L. REV. 271 (2008). Some scholars object on both philosophical and pragmatic grounds. See generally V.S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?*, 109 HARV. L. REV. 1477, 1520–32 (1996). Lest there be any doubt, I consider all these scholars first rate.

5. For a particularly good response, see Sara Sun Beale, *A Response to the Critics of Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 148 (2009).

substantial sentencing credit (or even immunity) if the corporation has adopted a minimally acceptable compliance plan (which, in this view, should produce internal monitoring that is better at preventing corporate crime than state-created penalties).

Some of these assumptions may have once been true but are inaccurate today. Others are a matter of faith or ideology without real empirical evidence to support them. Part I of this Article will examine these assumptions in light of current data, and our focus will be on the public corporation. Part II will then turn to the question of overdeterrence: Does the expected penalty typically exceed the expected gain? Does it seem likely that current penalties deter corporate offenders? Or is the likely penalty simply an acceptable cost of doing business? Although conclusive evidence is lacking (primarily because we know little about the volume of undetected violations of law by corporations), it is easy to find cases where the gain vastly exceeded the penalty imposed, suggesting that fines in such cases can be absorbed as a cost of doing business. Part III will then suggest means that enable us to focus the penalty on the key actors in corporate governance (and thereby avoid punishing at least most of the “innocent”).

One last introductory point: I am skeptical of the overused term “innocent” as applied to shareholders, managers, and other stakeholders. Civil liability also punishes the innocent in the corporate context, and civil courts probably impose the vast majority of the penalties imposed on corporations (as well as the largest). Moreover, this rhetoric about innocence misses half the picture: Because shareholders have limited liability, they do not face any risk of personal liability. I agree that we should not punish the powerless because that achieves nothing, but I argue that public policy should focus its legal threats on those who could have detected and prevented the crime (and might do so in the future). Who are they? That is an under-examined issue that is the subject of Part I below.

#### I. OLD MYTHS AND NEW REALITIES: WHO IS BEHIND THE CORPORATE CURTAIN?

One traditional truth remains valid: Corporations may not be sent to prison. Possibly, they can be sent to a “reformatory” (at least in a metaphorical sense), but this author is as skeptical of the feasibility of rehabilitation in the corporate setting as he is of its feasibility in the individual setting. Thus, as a practical matter, let us assume corporations can only be subjected to financial and reputational sanctions.<sup>6</sup> The fact that the corporation cannot be incarcerated (and is unlikely to be rehabilitated) supplies the first reason why the “punishing the innocent” theme, so stressed by opponents of corporate criminal liability, needs to be greatly discounted. To the shareholders who bear the costs imposed on the corporation (by public or private enforcers), there is little economic difference between a criminal fine, a civil penalty, or punitive damages imposed by private enforcement. Indeed, unless we are willing to say that the common law rule of respondeat superior is also unjust, it is hard to consider the fact that shareholders ultimately bear the penalties imposed on the

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6. Some, of course, want the corporation to be subject to a “death sentence” in the form of the loss of its corporate franchise. *See, e.g.*, MARY KREINER RAMIREZ & STEVEN A. RAMIREZ, *THE CASE FOR THE CORPORATE DEATH PENALTY: RESTORING LAW AND ORDER ON WALL STREET* 15–16 (2017). This would truly result in punishing the innocent (and powerless) to a far greater degree than any sanction in use today. I recognize that the corporation is also subject to the loss of its reputational capital, but this is an argument in favor of corporate criminal liability, as the criminal law can better employ such a penalty.

corporation as evidencing injustice. On the other side of the coin, unsurprisingly, some evidence does suggest that criminal penalties deter better than civil ones.<sup>7</sup> In this light, public policy should focus on whether the shareholders (or others who bear the cost) could have conceivably prevented the criminal conduct.

In that light, we next focus on the contemporary position of shareholders and managers in corporate governance.

#### A. Shareholders Today.

Since at least the time of Adolf Berle and Gardiner Means, it has been assumed that shareholders lacked the power to control management because they were too dispersed, and the exercise of control was too costly for them.<sup>8</sup> This assessment, of course, was summarized in their famous phrase about the “separation of ownership and control,” which they dated to the early 20th Century.<sup>9</sup> The federal securities laws, enacted in the 1930s, sought to reduce this separation but probably had only modest success.

What later changed was not the law, but the economics. Institutional investors arose, from a modest beginning in the 1950s to the current era in which they dominate corporate ownership.<sup>10</sup> In the case of large public corporations (such as those in the S&P 500), institutions today hold, on average, over 70% of the stock.<sup>11</sup> Even more importantly, this ownership has become highly concentrated, with the Big Three (the three largest asset managers in the United States) now owning over 23% of the equity in large corporations.<sup>12</sup> Add a few more mutual funds and pension funds to the Big Three, and absolute voting

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7. Andrew B. Miller, *What Makes Companies Behave? An Analysis of Civil and Criminal Penalties Under Environmental Law*, (Dec. 2005), [papers.ssrn.com/sol3/papers.cfm?abstract\\_id=471841](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=471841) [<https://perma.cc/S99TAYQE>]. Arguably, this may be truest in the environmental context because both the public and the press give closer attention to crimes and misbehavior in this context.

8. See ADOLF A. BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 242–46 (1932) (arguing that power shifted from shareholders to management because of the dispersion of stock ownership and the control of the proxy system).

9. *Id.* at 4–5.

10. For overviews of this transition (and the improvement in institutional monitoring), see John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor As Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 COLUM. L. REV. 863, 874–75 (2013).

11. The level of institutional ownership increases with the company’s market capitalization (because institutions need liquidity and thus prefer investing in large-cap stocks). If we look at U.S. companies that are among the 10,000 largest companies in the world, the percentage of institutional ownership is 72%, according to a recent OECD report. Adriana De La Cruz, Alejandra Medina & Yung Tang, *ORG. FOR ECON. COOP. & DEV., OWNERS OF THE WORLD’S LISTED COMPANIES* 11 tbl.3 (2019), <https://www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.htm> [<https://perma.cc/5JXM-9HD5>]. For our purposes, this is the most relevant grouping to consider because these companies have a greater impact on the global economy.

12. Professors Lucian Bebchuk and Scott Hirst have estimated the ownership percentage held collectively by the Big Three as 20% (and predicted that it would eventually rise to 40% or more). Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 724, 734 fig.1, 738 fig.2 (2019). A more recent OECD study placed this number at 23.5% in 2021. Serdar Celik & Daniel Blume, *New OECD Corporate Governance Reports and the G20/OECD Principles of Corporate Governance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 15, 2021), <https://corpgov.law.harvard.edu/2021/07/15/new-oecd-corporate-governance-reports-and-the-g20-oecd-principles-of-corporate-governance/> [<https://perma.cc/DD5J-T97C>].

control has been assembled.<sup>13</sup> Until relatively recently, these shareholders were reticent about involving themselves in corporate governance at portfolio companies, but that too is changing, as they now regularly involve themselves in proxy fights and even litigation.<sup>14</sup>

What is the relevance of this transition? If a partnership in which five or six partners held 80% of the equity were convicted of a crime, few would be shocked that most of this penalty fell on those five or six individuals. We understand intuitively that costs flow through the partnership to its partners. What then is different about convicting another legal entity (called a corporation) in which a small number of institutional investors also hold control? Again, on conviction, the penalty flows through to these owners (up to the ceiling set by limited liability). The main difference in the case of the corporation is that the shareholders have the protection of limited liability (and, in the case of public corporations, the shareholders are largely institutional investors and highly diversified, so that the penalty will be evenly spread across their beneficial owners, without disproportionate impact on any one such owner).

Under Delaware law (which applies to the majority of large corporations), control is easily exercised by those who own a majority of the stock. Unless there is a contrary provision in the corporation's certificate of incorporation, such a majority can simply sign and deliver an instrument to the corporation that removes directors (or the entire board) and appoints new directors.<sup>15</sup> To be sure, these large shareholders probably did not know of the crime in advance, but that may be because they were rationally apathetic about it. Today, they hold the power to control—but exercise it only in exceptional cases.<sup>16</sup>

In their defense, the largest institutional investors argue that they simply own too many stocks to be able to monitor each stock in their portfolio closely. State Street Global Advisors, which is one of the Big Three, currently owns 10,000 stocks on a long-term basis (meaning that it and similar large investors rarely sell or “exit” from their investments).<sup>17</sup> The truth is slightly more complex. Locked into intense price competition, the Big Three and other indexed institutional investors logically follow a common strategy of cost minimization and thus resist expending funds on monitoring. Beyond this claim that they have a limited capacity to monitor, there is a larger point: they gain little from such

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13. For example, the stock in publicly held companies (in terms of asset value) that is held by the ten largest mutual funds rose from 46% in 2005 to 64% in 2019 (and the five largest mutual funds held 53% on this basis in 2019). INV. CO. INST., INVESTMENT COMPANY FACT BOOK 46 fig.2.14 (60th ed. 2020), [https://www.ici.org/system/files/attachments/pdf/2020\\_factbook.pdf](https://www.ici.org/system/files/attachments/pdf/2020_factbook.pdf) [<https://perma.cc/U4RE-LMWJ>].

14. See generally Elroy Dimson, Oğuzhan Karakaş & Xi Li, *Coordinated Engagements* (Eur. Corp. Governance Inst., Working Paper No. 721/2021), <https://ssrn.com/abstract=3209072> [<https://perma.cc/C3LZ-HJNT>] (finding an “international network of long-term shareholders cooperating to influence firms on environmental and social issues”). For a finding that diversified investors are today suing portfolio companies, see Alexander I. Platt, *Index Fund Enforcement*, 53 U.C. DAVIS L. REV. 1453, 1458–59 (2020).

15. See DEL. CODE ANN. tit. 8, § 141(k) (2022) (permitting any director or the board as a whole to be removed, “with or without cause, by a majority of the shares then entitled to vote”). This power can be exercised by executing a written consent signed by such a majority and delivered to the corporation. See DEL. CODE ANN. tit. 8, § 228 (2022).

16. Cyrus Taraporevala, *Race & Ethnicity and the Role of Asset Stewardship*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 27, 2021), <https://corpgov.law.harvard.edu/2021/03/27/race-ethnicity-and-the-role-of-asset-stewardship/> [<https://perma.cc/4AKW-VYXX>] (asserting that owners of long-term stocks tend to adopt a more *laissez-faire* approach in managing their investments).

17. Cyrus Taraporevala, the CEO of State Street Global Advisors, made this estimate in March 2021 and emphasized that State Street was holding these stocks for the long term. See *id.*

monitoring. Because large institutional investors are highly diversified, they are largely insulated from firm-specific risk (which category includes criminal penalties). Criminal (or civil) penalties flow through these institutions to the thousands of beneficial holders on whose behalf these institutions hold stock. This mitigates the impact on these investors and further erodes the incentive to monitor. Perhaps if corporate criminal penalties were much higher, their incentives might change. But, as later discussed, this would also impose burdens on other corporate stakeholders (i.e., employees, creditors, local communities, etc.).

### B. Senior Managers.

The other major stakeholder in our contemporary corporate governance system who could be more meaningfully deterred is the control group of the corporation's senior managers. To illustrate the shortfall here, let us consider a case where a relatively junior manager of a U.S. public corporation pays a series of bribes to foreign officials somewhere abroad in order to obtain or retain business for the corporation. This conduct almost certainly violates the Foreign Corrupt Practices Act (FCPA).<sup>18</sup> But no senior manager at the corporation authorized these bribes or otherwise induced the junior manager to make the payments. Senior management may have had some knowledge that bribery was occurring in that division (but it started long ago, and they never encouraged it). On these facts, it is unlikely that any senior manager can be successfully prosecuted for aiding and abetting the FCPA violation or for being part of a conspiracy to violate the FCPA.<sup>19</sup>

Only the corporation and the junior manager thus face criminal liability, and the senior management may rationally choose to ignore what is happening at a lower level in the corporation. From its self-interested perspective, ignorance is bliss. If the crime is highly profitable, senior managers are not only motivated to overlook signs of misconduct, but possibly even to pressure junior officers to cut legal corners and avoid being "excessively" law compliant. Without implicating themselves, senior managers can direct a mixture of positive incentives and negative threats toward junior managers, encouraging them to take more legal risks. Thus, we again have another possible leverage point (senior management) that is being largely ignored and wasted today.

The answer here is not to make the senior manager criminally liable for negligence. This would amount to vicarious liability and would be resisted by all civil libertarians (and probably most lawyers). But there may be an intermediate alternative. Here, let us return to Professor Alschuler's earlier criticism that corporate criminal liability resembles the

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18. The Foreign Corrupt Practices Act of 1977, 15 U.S.C. § 78a *et seq.*, is a federal statute that generally forbids U.S. persons and entities from paying bribes to foreign officials and certain others to obtain or retain business.

19. Aiding and abetting a federal felony is prohibited by 18 U.S.C. § 2, which deems a person who "aids, abets, counsels, commands, induces or procures" the commission of the crime to be liable as a principal. The case law indicates, however, that "[T]he elements necessary for an aiding and abetting conviction are: (i) that the accused had the specific intent to facilitate the commission of the crime by another, (ii) that the accused had the requisite intent of the underlying substantive offense, (iii) that the accused assisted or participated in the commission of the underlying substantive offense, and (iv) that someone committed the underlying substantive offense." See *United States v. Sineneng-Smith*, 910 F.3d 461, 482 (9th Cir. 2018), *vacated*, 140 S. Ct. 1575 (2020). For the earlier Supreme Court decisions construing this offense, see *Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949); *Rosemond v. United States*, 572 U.S. 65, 76 (2014).

medieval system of frankpledge, which held the group liable for the misconduct of a member of the group.<sup>20</sup> This idea of group liability should not automatically offend us but should be developed in a manner consistent with due process.<sup>21</sup> If a group penalty can be devised that is proportionate to management's apparent tolerance of illegality, it largely solves the difficulty of attributing the misconduct to any specific individual and avoids vicarious liability in the traditional sense.

Senior management is a relatively cohesive group that shares much knowledge. Let us assume that it would be unthinkable (or at least politically unacceptable) to make a senior manager subject to a large civil fine simply for negligent ignorance (or even a dim awareness that unlawful behavior was occurring at lower levels). This is too close to vicarious liability to be politically feasible. But, as later discussed, a modified "frankpledge" system can be designed that would visit an indirect cost on senior managers as a group by denying them certain compensatory benefits when their corporation is convicted of a serious crime. This de facto penalty would not impose a fine, but would focus on those who could have monitored more closely but did not. Also, because this restraint is not imposed on any named individual, this approach involves less stigmatization and individual reputational loss.

The design of such a penalty will be deferred to a later section, but it must be conceded that this would resemble, to a degree, the old institution of the frankpledge (which arguably worked in its time<sup>22</sup>) because the group is made to bear some cost because of the conduct of one of its members.<sup>23</sup> Rather than impose a penalty, it would simply deny certain benefits (namely, incentive compensation) to those who sit in high executive positions at a large corporation during a period of corporate probation. The rationale here has three parts: (i) incentive compensation can be criminogenic in that it encourages excessive risk-taking; (ii) incentive compensation is an award for high performance, and a convicted corporation should not be regarded as having performed at a high level; and (iii) we suspect that senior managers quietly tolerated active misconduct without intervening. These managers are neither "guilty" in a legal sense nor "innocent" in an ethical sense, and the "punishment" must therefore be tailored to fit their intermediate status.

### C. Criminal vs. Civil Offenses

The standard critique of corporate criminal liability begins with the assertion that the criminal law imposes much harsher penalties than does the civil law and then adds the claim that these harsher penalties fall on the innocent.<sup>24</sup> In the case of criminal defendants who are individuals, this assertion seems generally accurate (because individuals do go to prison). But if corporations are generally subject to only financial penalties, the inconvenient truth is that the civil law (through both public and private enforcement) seems

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20. Alschuler, *supra* note 1, at 1359.

21. *Id.* at 1366–67.

22. Professor Alschuler points out that the frankpledge system had some efficiency advantages because in its time, "there were no professional police forces," and thus, it imposed an enforcement obligation on virtually "everyone." *Id.* at 1362. Effectively, sanctions aimed at senior management also convert them into involuntary enforcers.

23. *Id.* at 1359.

24. *See generally id.*

today to be imposing significantly higher penalties than the criminal law.<sup>25</sup>

This pattern has accelerated since the 2008 financial crisis. As of 2009, the highest criminal fine imposed in a Department of Justice prosecution or settlement was \$1.195 billion (which was imposed that year against Pfizer, Inc. and a subsidiary for the illegal promotion of certain drugs for “off-label” uses).<sup>26</sup> Even in this case, another \$1 billion was paid to the government as the result of a civil action under the False Claims Act.<sup>27</sup> Since then, the record for the highest fine has been regularly broken, and the current record is held by BNP Paribas (“BNP”), a French bank, which received an \$8.9 billion penalty for permitting certain aliens to trade in U.S. dollars contrary to U.S. regulations.<sup>28</sup> As has become typical, this penalty was split into a \$4 billion criminal fine and a nearly \$5 billion civil amount paid to various regulators.<sup>29</sup>

Not only is the civil penalty often greater than the criminal penalty, but in a high percentage of cases, there may be no criminal penalty at all. Professor Brandon Garrett found—in a study that included 255 criminal cases between 2001 and 2012—that in nearly half of these cases (47%), there was no criminal fine.<sup>30</sup> Prosecutors were seemingly content with whatever fine was paid to the regulatory agency. Even in cases where criminal fines were paid, they were typically at the low end of the sentencing guidelines.<sup>31</sup> This may suggest that weak compromises were made, with prosecutors conceding the penalty in order to get an admission of liability.

At regulatory agencies, exemplary penalties have become common, often for behavior that was more *malum prohibitum* than *mala in se*.<sup>32</sup> A good example is the enormous settlements by bank regulators with the largest banks in the wake of the 2008 crisis. Here, the largest settlements were reached with Bank of America for nearly \$16.7 billion in 2014 and J.P. Morgan Chase Bank for \$13 billion in 2013.<sup>33</sup> Yet, these two cases did not involve

25. See, e.g., Steven Schaefer, *BNP Paribas Hit With Nearly \$9 Billion Fine, Pleads Guilty to Skirting U.S. Sanctions*, FORBES (June 30, 2014, 6:15 PM), <https://www.forbes.com/sites/steveschaefer/2014/06/30/bnp-paribas-hit-with-nearly-9b-fine-pleads-guilty-to-skirting-u-s-sanctions/?sh=5a3b3c053c02> [<https://perma.cc/5SB7-FL7P>] (discussing BNP Paribas’ civil and criminal penalties).

26. See *Justice Department Announces Largest Health Care Fraud Settlement in Its History*, U.S. DEPARTMENT OF JUSTICE (Sept. 2, 2009), <https://www.justice.gov/opa/pr/justice-department-announces-largest-health-care-fraud-settlement-its-history> [<https://perma.cc/R23J-5F59>] (noting that the “criminal fine of \$1.195 billion [was] the largest criminal fine ever imposed in the United States for any matter”).

27. *Id.*

28. See Schaefer, *supra* note 25 (discussing BNP’s guilty plea); see also Joel Slawotski, *Reining in Recidivist Financial Institution*, 40 DEL. J. CORP. L. 280, 283 (2015) (discussing BNP and Bank of America resolving investigations).

29. See *BNP Paribas Sentenced for Conspiring to Violate the International Emergency Economic Powers Act and the Trading with the Enemy Act*, U.S. DEPARTMENT OF JUSTICE (May 1, 2015), <https://www.justice.gov/usao-sdny/pr/bnp-paribas-sentenced-conspiring-violate-international-emergency-economic-powers-act> [<https://perma.cc/HMH5-HB3J>] (discussing the breakdown of the fines paid by BNP Paribas).

30. See BRANDON GARRETT, *TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS* 149 (2014).

31. *Id.* at 150.

32. “*Mala in se*” is a Latin phrase that means wrong or evil in itself (for example, homicide or armed robbery). The average citizen is fully aware that it is forbidden. In contrast, “*Malum prohibitum*” means that the conduct is wrongful because it has been prohibited and not that it is inherently evil.

33. See JOHN C. COFFEE, JR., *CORPORATE CRIME AND PUNISHMENT: THE CRISIS OF UNDERENFORCEMENT*

any indictment or even a clear threat of criminal prosecution. Nor is assembling a portfolio of very risky mortgage-backed securities and marketing them to sophisticated institutional investors so obvious a sin that it was listed on the two tablets that Moses brought down from the mountain. In both cases, the banks settled at a very early stage, probably in order to terminate pending investigations.<sup>34</sup> This willingness to settle early suggests that banks and certain other corporate defendants fear reputational damage more than the financial penalties under current law.<sup>35</sup>

Regulatory agencies have similarly escalated their penalties (which are necessarily civil as they lack criminal jurisdiction). The FTC fined Facebook \$5 billion in 2019, which topped by several orders of magnitude its prior record penalty of \$22.5 million (imposed against Google), but Facebook's stock price still rose on the announcement.<sup>36</sup> The SEC has followed a similar pattern, with numerous civil settlements now exceeding the \$1 billion level.<sup>37</sup>

Not only do civil penalties often appear to be as large as or larger than criminal penalties, but they are in turn dwarfed by private class actions, some of which follow the resolution of earlier actions brought by public enforcers. Here, the latest example is a \$26.1 billion pending class action settlement between the states, three opioid distributors, and Johnson & Johnson.<sup>38</sup> Many other lawsuits asserting opioid liabilities remain pending, and one state attorney general has estimated that if all the states joined the current \$26 billion settlement, the total amount for liabilities to the states and certain municipalities would be near \$33 billion.<sup>39</sup>

The initial point here is not that these penalties will be adequate to deter (that is a different and much more complex question), but that criminal penalties probably account for only a small percentage of the total financial sanctions imposed on corporations by

62, 65–66, 172 n.27 (2020) (providing a list of largest corporate penalties, both civil and criminal). This list was created by Professor Brandon Garrett at Duke University Law School and is now maintained at the University of Virginia Law School.

34. *Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis*, U.S. DEPARTMENT OF JUSTICE (Aug. 21, 2014), <https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading> [https://perma.cc/CY39-VPPM]; *Justice Department, Federal and State Partners Secure Record \$13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages*, U.S. DEPARTMENT OF JUSTICE (Nov. 19, 2013), <https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-13-billion-global-settlement> [https://perma.cc/K42J-XUSC].

35. There is considerable literature on this point, suggesting that reputational damage is more important than the financial penalty. Of course, this finding was based on data covering the penalties imposed before the U.S. Sentencing Commission raised corporate penalties. For leading examples, see Jonathan M. Karpoff & J. R. Lott, Jr., *The Reputational Penalty That Firms Bear for Committing Criminal Fraud*, 36 J.L. & ECON. 757, 758 (1993) (finding from 132 large corporate fraud cases, reputational damages vastly outweighed legal penalties); Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 581, 581 (2008).

36. See COFFEE, *supra* note 33, at 64. The stock of Facebook rose 1.8% on the day that this record penalty was announced. *Id.* at 65.

37. See Tiffany Raiford, *The Biggest SEC Fines in History*, WORTHLY, <https://worthly.com/news/15-biggest-sec-fines-history> [https://perma.cc/49TB-7UB5] (listing the most expensive SEC penalties).

38. Jan Hoffman, *\$26 Billion Deal Reached to Drop Opioid Lawsuits*, N.Y. TIMES (July 22, 2021), <https://www.nytimes.com/2021/07/21/health/opioids-distributors-settlement.html> [https://perma.cc/T2Z9-NW9T].

39. See *id.* (quoting Attorney General Josh Stein of North Carolina).

public and private enforcers. Nor is there a clear rationale apparent as to when public agencies use criminal versus civil penalties. When a large corporate scandal occurs today, a broad array of state and federal regulators descend like a posse, assert overlapping claims, and frequently reach a collective settlement.<sup>40</sup> The public often has little sense of whether this is a civil or criminal proceeding; in truth, large banks may fear the Federal Reserve Board more than the Department of Justice.

Still, skeptics may respond that this argument overlooks the unique ability of the criminal law to employ shame and humiliation as a means of deterrence. No doubt, the prospect of reputational loss does threaten and motivate corporations (and probably accounts for the early stage at which large settlements have been struck in some of the largest bank cases in order to minimize adverse publicity).<sup>41</sup> Yet, even if the reputational injury can deter, public corporations have found an effective means by which they can largely sidestep this adverse publicity. The recent popularity of Deferred Prosecution Agreements (DPA) and Non-Prosecution Agreements is driven, at least in substantial part, by the fact that they allow corporations to escape this publicity, at least in comparison to the high drama of a public criminal trial. Even better than a DPA (which does typically set forth the charges in considerable factual detail) is a settlement reached early on in the investigation stage when no charges have yet been specifically made. The bottom line is that shame may well deter, but do not underestimate the ability of skilled defense counsel to avoid and outflank it.

One last point about both civil and criminal penalties as they have been recently imposed: they almost never result in a stock price decline on (or shortly after) the date of their announcement, even when the fine is so high (often in the billions of dollars) that it establishes a new record.<sup>42</sup> What does this imply? It would be much too quick and superficial to conclude that this means the criminal law cannot deter public corporations. In fact, the impact on the defendant's stock price often comes well before conviction or sentencing at the earlier point when the likelihood of criminal enforcement first becomes publicly known.<sup>43</sup> This suggests that the reputational cost to the firm from the scandal drives down its stock price,<sup>44</sup> whereas the fine imposed in sentencing has less impact, if any at all, on the stock price. In short, a reputational loss may often exceed and precede the impact of financial penalties.

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40. See, e.g., Hoffman, *supra* note 38 (discussing the various entities who brought suit against drug distributors, including state and city governments).

41. See *supra* notes 33–37 and accompanying text.

42. See COFFEE, *supra* note 33, at 65–67 (calculating the stock price reaction on the date on which the largest recent civil and criminal penalties were announced and finding the market's reaction to be generally positive). This evidence does not show that corporations are indifferent to criminal prosecution but does suggest corporate fear may be more over the adverse publicity generated (and in the case of managers, over the risk of individual prosecutions). Today, the fine in a criminal case looks much like the tail on the dog, the last and least important step that seldom moves the market.

43. See Jonathan M. Karpoff & John R. Lott, Jr., *The Reputational Penalty that Firms Bear from Committing Criminal Fraud*, 36 J.L. & ECON. 757, 775–85 (1993) (finding that the reputational loss occurs at the time that the initial news reports appear, indicating the likely enforcement action).

44. "Reputational loss" is a portmanteau term that needs to be unpacked, as it can be used to mean a variety of losses. As used herein, it can include both the losses to the corporation because consumers may back away from the firm's products or services based on the scandal, because the firm may experience a period of paralysis while it deals with the enforcement agencies, and because news reports may signal that the firm will have reduced cash flow in the future.

In this light, consider again how unjustifiable and onerous the punishment imposed on “innocent” shareholders actually is if (i) record fines are accompanied by a positive stock market reaction and (ii) civil penalties and class action recoveries exceed the criminal penalties that are imposed.

## II. HOW WELL DO FINANCIAL PENALTIES DETER AND ENFORCE LAW COMPLIANCE?

The fact that the stock market seldom reacts adversely to the announcement of even a record penalty does not prove by itself that the corporation has not been deterred. Under classic economic theory, deterrence requires that the expected penalty exceed the expected gain.<sup>45</sup> This is an almost impossible calculation to make in the real world because we lack data about: (i) the amount of unreported and undetected corporate malfeasance; (ii) the likelihood of apprehension (which percentage must then be multiplied times the likely penalty to obtain the “expected” penalty); and (iii) the likely gain (which often will be highly speculative). But circumstantial evidence suggests that financial penalties for large corporations remain modest in proportion to the expected gains (even though the penalties have recently soared).

First, there may be an order of magnitude difference between the amount of misconduct detected by the large corporation (based on their own internal records) and the amount reported in public enforcement data. Here, Harvard Business Professor Eugene Soltes—after studying the internal records of several large multinational firms—estimates that there are at least two instances of internally-recorded corporate misconduct per week per firm.<sup>46</sup> This is an off-the-charts disparity and suggests that corporate compliance plans miss much. Second, even if we cannot reliably estimate the risk of apprehension, this apparent high volume of unreported misconduct suggests that the risk of apprehension may be quite low. Third, actual penalties do not appear to significantly threaten most public corporations. For example, Professor Brandon Garrett has computed the ratio of the fines imposed on public corporations between 2001 and 2012 to their market capitalizations and found that these fines averaged only 0.04% of the corporation’s market capitalization.<sup>47</sup> That kind of potential loss is not likely to keep the CEO awake at night.

### A. The Limited Available Evidence

Rare as it is to find evidence of both the gain and the penalty, those cases that present such evidence tend to show that the penalty is modest in proportion to the gain. Sometimes in settlement agreements, the defendant will concede the amount of damages that its

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45. See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 207–08 (1968) (noting that, from an economist’s point of view, deterrence is most effective when costs imposed on crime are higher than any gains received). Thus, if one assumes a 50% risk of apprehension (which is high for most crimes), the penalty would have to be logically increased to twice the expected gain in order to compensate for the limited risk of apprehension.

46. Eugene Soltes, *The Frequency of Corporate Misconduct: Public Enforcement vs. Private Reality*, 26 J. FIN. CRIME 923, 923 (2019). Although one study will not allow us to put any reliable estimate on the amount of unreported corporate misconduct, this initial study certainly suggests that internal corporate compliance plans may be missing much misconduct.

47. GARRETT, *supra* note 30, at 63. This percentage rises to 0.09% if one includes restitution and disgorgement paid by the defendant. *Id.* Given the small size of these penalties on this basis, this may help explain why the market does not respond negatively to even record penalties.

conduct has caused. This anecdotal evidence indicates that the penalty imposed on a public corporation was only a small fraction of the gains that it conceded. For example, The Wall Street Journal studied the earlier-noted BNP case in which the bank paid a record \$8.9 billion penalty and found that for every dollar of alleged gains received, the bank paid only \$0.27 to \$0.30 in penalties.<sup>48</sup> Thus, to make the expected penalty exceed the expected gain on these facts, we would need to increase the penalty by nearly seven times (and this requires that we assume an improbably high 50% apprehension rate).<sup>49</sup> Another similar example has been discovered by Professor Brandon Garrett, who found that Standard Chartered, another international bank, pleaded guilty in the United States for violating Iranian sanctions and allegedly hiding some \$240 billion in illegal transactions with Iranian clients that yielded it some \$7 billion in gains.<sup>50</sup> What did it pay in fines? Only \$674 million in combined civil and criminal penalties.<sup>51</sup>

These seemingly inadequate penalties point to a key dilemma: If we were to assume the risk of apprehension was hypothetically 25%, the expected penalty for Standard Chartered would have to be raised to \$28 billion to cancel the \$7 billion expected gain. Such a penalty would almost certainly force the bank into bankruptcy for behavior that is only a *malum prohibitum* violation. These cases are far from rare. Also, many of the more flagrant corporate violations recently have involved companies that were already in deep financial trouble and arguably on the brink of insolvency (for example, Pacific Gas & Electric, Purdue Pharma, and Boeing). Public policy cannot be happy with imposing such potential death sentences.

Equally important, sentencing judges do not exist in remote ivory towers, immune from public and political pressure. Any exemplary penalty (and certainly those in the billions of dollars) will produce a predictable reaction from defense counsel: They will inform the court that its proposed penalty will force the corporation to close plants, curtail services, lay off employees, etc. Sometimes, this may be true; Other times, it will be an exaggeration, but few judges want to win notoriety for imposing a death sentence on a large corporation. The result is the judges pull their punches and stay close to historical penalty averages. In addition, harsh fines can be appealed on the grounds that they violate the “excessive fines clause” of the Eighth Amendment.<sup>52</sup> To avoid such a challenge, even the

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48. See generally William Hobolin, *France Claims Victory in BNP Paribas Case*, WALL ST. J. (July 1, 2014, 6:38 AM), <https://www.wsj.com/articles/france-claims-victory-in-bnp-paribas-case-1404211120> [<https://perma.cc/FA5D-JM4M>]; See also Nick Werle, *Prosecuting Corporate Crime When Firms are Too Big to Jail*, 128 YALE L.J. 1366, 1376 (2019) (“BNP Paribas ultimately pled guilty and paid \$8.9 billion, but no individuals were prosecuted.”).

49. Because the actual penalty came to only 30% of the gain and the apprehension rate was hypothetically assumed to be 50%, the expected penalty would need to be double the expected gain and this would require that we increase the penalty by nearly seven times.

50. Brandon Garrett, *The Rise of Bank Prosecutions*, 126 YALE L.J.F. 33, 40 (2016); Kristie Xian, *The Price of Justice: Deferred Prosecution Agreements in the Context of Iranian Sanctions*, 28 NOTRE DAME J.L. ETHICS & PUB. POL’Y 631 (2014); New York state regulators alleged that the bank hid \$250 billion in these transactions. Stephen Joyce & Len Bracken, *Money Laundering: Standard Chartered Hid \$250 Billion in Iran Dealings*, *New York Regulator Says*, 99 BNA’S BANKING REPORT 294 (Aug. 14, 2012).

51. Garrett, *supra* note 50, at 40.

52. “Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.” U.S. CONST. amend. VIII. If the fine is disproportionate to the offense, the appellate court can invalidate it. See *United States v. Bajakajian*, 524 U.S. 321, 323 (1998) (noting that forfeiture of respondent’s entire

prosecutor may be willing to scale down the penalty, rather than spend years in appellate courts arguing the appeal.

### *B. Are Corporations Over Deterred?*

This is a standard claim (or at least a standard fear) of critics who disfavor corporate criminal liability. But does it seem plausible? Definitionally, excessive deterrence would require the expected penalty for unlawful conduct to exceed the expected gain. Although these variables are hard to measure, we know that some forms of criminal conduct in the white-collar setting remain prevalent. A good example is insider trading, which persists despite many successful prosecutions. We know it persists because the stock prices of target corporations in merger and acquisition transactions soar well above their prior prices in the days just before the merger or other transaction is announced. The conclusion is hard to avoid that a low rate of apprehension characterizes this crime, and few would suggest that we can respond to this problem by imposing life sentences (which seem disproportionate to the severity of the offense).

Insider trading does not stand alone. Money laundering has become much safer in the contemporary world, where money can be moved globally and virtually instantaneously through cryptocurrencies. Further, even crimes that seem eventually destined to be discovered (for example, a Ponzi scheme) can persist for decades. Bernard Madoff kept his extraordinarily underfunded Ponzi scheme operating for apparently 30 years (despite the suspicions of many). Similarly, Enron, WorldCom, and a host of other public companies were all financial houses of cards that produced record bankruptcies, but no prosecutor acted until after these firms had failed. The claim here is not that U.S. corporations are chronically lawless (indeed, this author believes they are more law compliant than corporations incorporated elsewhere), but that public monitoring is weak (and underfunded) and larger corporations are insulated because U.S. law does not authorize sufficient penalties to cancel the expected gains. Compounding this problem is that penalties may be kept low, either because of political opposition or for other, more understandable reasons. The costs of higher penalties that would equal the expected gain are probably unacceptable.

Why is this? Politically, it is unacceptable to say that large corporations are “too big to jail,” but it may remain true empirically. Several reasons can be given: (i) inflation trivializes even penalties that were harsh when originally adopted, and legislatures do not rush to update them (because powerful lobbies will oppose penalty escalation); (ii) the public does not understand either the volume of corporate crime or the disparity between the low expected penalty and the high expected gain; and (iii) exemplary financial penalties that truly cancel the gain would result under the present law in corporate bankruptcies that would produce social and economic dislocation and possible recession.

So, what can be done? Two general answers seem possible. First, we can try to focus more on individual defendants (who cannot absorb criminal sentences as a cost of doing business). Second, to the extent exemplary corporate penalties are needed, we can try to limit their “overspill” so that they do not fall on those who were powerless and could not

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\$357,144 was not proportionate to the government’s injury). This provision has also been extended to the states by means of incorporation under the Fourteenth Amendment. *See Timbs v. Indiana*, 139 S. Ct. 682, 687 (2019) (holding the Eighth Amendment applicable to the states via incorporation through the Fourteenth Amendment).

prevent the criminal conduct. Neither approach has a self-evident means for its implementation. Even if individual liability is preferable, it is not easy. Corporate executives are hard to convict by proof beyond a reasonable doubt, particularly in settings where decision-making is decentralized and multinational.

In this light, this Article will suggest three proposals:

- I. The use of probation conditions that would be imposed on a convicted corporation, limiting its ability to award incentive compensation (including stock options) during a period of corporate probation on the rationale that such compensation can be criminogenic and encourage excessive risk-taking; the consequence of such a sanction is that its true cost falls on senior managers as a group—in effect, a modified frankpledge system;
- II. The equity fine—an exemplary penalty to be used only in extreme cases that would impose the fine in stock rather than cash (so that the penalty is not borne by employees, creditors, local communities, and other stakeholders); the key advantage of such a penalty is that it does not affect a corporation's cash flow and should not therefore harm employees, creditors, or other stakeholders (except, of course, for shareholders); and
- III. A revised approach to the DPA that would require corporations to turn themselves in and identify all officers or employees who had any role, involvement, or knowledge in the crime—thus requiring a much higher price for corporate leniency.

It understates to say that each of these proposals would be extremely controversial.

### III. MAKING THE PUNISHMENT FIT THE CORPORATION

The case for corporate criminal liability depends in part on whether adequate penalties can be designed that deter the corporation without inflicting unacceptably negative externalities on innocent stakeholders. Here, problems lurk, as some penalties can be absorbed as a cost of doing business, but other penalties, such as reputational loss, are hard to estimate or control and may not be true penalties at all.<sup>53</sup> Presumably, the market reduced the price of Enron's stock as it approached bankruptcy not because it wanted to punish Enron, nor because it perceived that Enron's former stock price premium for its allegedly superior corporate governance was no longer justified, but simply because it now recognized that Enron was a failure that faced only negative future cash flows.

This section will discuss how this article's view of corporate criminal liability justifies new and distinctive penalties designed to deter and incapacitate.

#### *A. The "Group" Penalty of Reduced Incentive Compensation.*

Senior executives at public corporations (and particularly the CEO) receive the majority of their compensation in the form of equity (both stock options and stock awards),

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53. For example, the stock market's adverse reaction to the news that a corporation is caught in a legal crisis may simply reflect a new and more accurate estimate by the market of the corporation's future cash flows. This reaction is not intended as a penalty, but simply reflects the normal response of a relatively efficient market to new information.

which is normally paid on a contingent basis.<sup>54</sup> Intended as an incentive to motivate and induce executives to “listen to the market,” equity compensation also acts as an incentive to take more risk.<sup>55</sup> Overall, it may be the shareholders’ right to want a slow-moving, laggard corporation to take more risk and be more innovative—at least up to a point. Incentivizing the senior manager to take more legal risk is, however, a different matter, but equity compensation, paid on an incentive basis, does this also.

Here, it is also useful to consider an actual case in which incentive compensation appears to have had a criminogenic impact. Valeant Pharmaceuticals, International is a notorious example of dysfunctional corporate governance.<sup>56</sup> What caused the spotlight to shine on it (and cause Congress to hold hearings) was its business model of buying the patents on prescription drugs (or the companies owning these patents) and then raising the prices of those drugs up to 600 percent or more. This was possible because it sought drugs (often with a small market size) that had no clear competitor. Eventually, after a criminal investigation, its stock price fell, and managerial changes followed.

What caused this pattern of seemingly predatory behavior that had few, if any, defenders? Much of the answer may lie in an extreme compensation formula used to compensate its CEO. Designed by a hedge fund that was a leading Valeant shareholder and that wanted to motivate Valeant’s management to take on more risk, the compensation contract for the Valeant CEO paid him only \$1 million in cash annually, but then added equity compensation based on the following three-year compounded shareholder return:

If the three-year shareholder return was less than 15%, zero additional shares vested;

If the three-year total shareholder return was increased by between 15% to 29%, 407,498 shares vested;

If the three-year total returns increased by between 30% to 44%, 814,996 shares vested; and

If the three-year total returns increased by 45% or more, 1,222,494 shares vested.<sup>57</sup>

Such a formula pays the CEO to focus on the company’s stock price—and little else.

So motivated by the “all-or-nothing” character of this formula, the CEO caused his

54. Equilar, a compensation consultant, estimates that the share of CEO compensation (at companies in the S&P 500) derived from equity was 60% (with cash accounting for 36%). See EQUILAR, 2015 CEO PAY STRATEGIES 9 (2015), <https://www.equilar.com/press-releases/34-2015-CEO-pay-strategies.html> [<https://perma.cc/3MMV-8JSC>].

55. See Jeff L. Coles, Naven D. Daniel & Lalitta Naveen, *Managerial Incentives and Risk Taking*, 79 J. FIN. ECON. 431, 432 (2006) (noting that high potential equity compensation increases the manager’s incentive to make riskier decision with a high upside); see also David F. Larcker, Gaika Ormazabal, Brian Taylor & Donald Taylor, *Follow the Money: Compensation, Risk, and the Financial Crisis*, STAN. CLOSER LOOK SERIES, Sept. 2014, 1, 9.

56. See DAVID F. LARCKER & BRIAN TAYAN, CEO PAY AT VALEANT: DOES EXTREME COMPENSATION CREATE EXTREME RISK? I (Stan. Closer Look Series ed., 2016), <https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-56-ceo-pay-valeant-extreme-pay-risk.pdf> [<https://perma.cc/FDT2-NHBM>].

57. See *id.* (The authors estimate the value of this equity compensation package at \$16 million).

firm to increase prices on drugs that were vital to a limited audience by 600% or more.

One can deplore the ethical insensitivity of this CEO, but we cannot ignore that this behavior may have been caused by the compensation system under which he was paid. Incentivized to engage in practices that no other company had ever attempted, he did just what he was paid to do.

Such a case does not stand alone.<sup>58</sup> But what can be done? Neither Congress nor the courts are about to write detailed rules of executive compensation based on a limited number of extreme examples. Nor need they. The appropriate moment to intervene may come at the sentencing of a convicted corporation (or when a corporation seeks a DPA). At this point, federal law authorizes the sentencing court to impose probation conditions on the corporation (in addition to a fine and any other sanctions). Nor may the defendant corporation decline probation (at least in federal court).

What sort of probation conditions might be imposed? Traditionally, one purpose of probation conditions was to prevent recidivism, and federal law recognizes this purpose.<sup>59</sup> But how do you prevent recidivism? One way might be to discourage risk-taking on legal issues. In that light, consider a probation condition that precluded the convicted corporation for a probationary period from awarding more than a modest level of equity compensation to its senior executives (or to some defined group of them in the corporate offices involved in the crime). This restraint accomplishes two things at once: First, it reduces any compensation-fueled incentive to take excessive risk, and second, it imposes a sanction

58. Another good example would be WorldCom. After it failed in 2002, the court handling the SEC's action against WorldCom appointed Richard C. Breeden, the former chairman of the SEC, as a monitor to study the causes of WorldCom's collapse. His report focused on WorldCom's compensation practices and noted that:

The compensation practices of WorldCom allowed lavish compensation, far beyond any rational calculation of value added by senior executives. . . . Compensation abuse at WorldCom is most vividly symbolized by more than \$400 million in loans from shareholders to Ebbers (its CEO) that were put in place initially by two directors who were long time associates of Ebbers.

RICHARD C. BREEDEN, RESTORING TRUST: REPORT TO THE HON. JED S. RAKOFF, UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK, ON CORPORATE GOVERNANCE FOR THE FUTURE OF MCI, INC. 2 (Aug. 2003), <https://www.sec.gov/Archives/edgar/data/723527/000119312503044064/dex992.htm> [<https://perma.cc/F2UP-P8Z5>]. Therein, Breeden concluded that the existence of these loans and massive stock grants placed WorldCom's executives under great pressure to maintain and inflate WorldCom's stock price through dubious accounting stratagems. *Id.* at 2.

Many other examples of fraudulent conduct motivated by compensation practices could be cited here. For a fairly comprehensive overview of such fraudulent conduct by large financial institutions in the era of the 2008 crisis and before, see generally Slawotsky, *supra* note 28. The point here is not to assert that financial institutions or other public corporations are generally lawless, but only that some are, possibly because corporations and their managers do not face formidable legal threats today.

59. The Federal Sentencing Guidelines Manual expressly authorizes a sentence of probation for organizations (including corporations) that can be combined with other penalties, such as fines. *See* U.S. SENTENCING COMMISSION GUIDELINES MANUAL (U.S. SENTENCING COMM'N 2018) (describing how sentences and other penalties may be combined to punish convicted wrongdoers). Under § 8D1.1(a)(6) of THE MANUAL, probation conditions can be justified by the need to "ensure that changes are made within the organization to reduce the likelihood of future criminal conduct." Similarly, the Sentencing Reform Act, which established the Sentencing Commission, sets forth several statutory purposes to guide the commission, one of which is "to protect the public from further crimes by the defendant." *See* 18 U.S.C. § 3553(a)(2)(C). It is not here suggested that a sentence of probation should always be imposed, but in cases such as Valeant and WorldCom, the need for controls on compensation seem clear. Very simply, extreme compensation can produce extreme risk-taking, particularly when the compensation is contingent on maintaining or increasing the stock price.

that may both deter senior executives from breaking the law and also cause them to monitor lower-level employees more closely to prevent them from engaging in legal violations. The senior executive becomes (to a limited extent and for only a limited period) a surety for his junior colleagues, as he may suffer economically if they legally transgress. In effect, this restraint enforces the duty of care.

Ideally, senior managers are incentivized to become agents of law enforcement; they need to stop the rogue employee who is about to transgress before he forfeits their incentive compensation. Of course, the key penalty here would not be automatic. Before the suspension of incentive compensation would become applicable, some finding might be required that compliance systems were substandard or that managers foresaw some risk of legal non-compliance. But the mere existence of a compliance plan on paper should count for little. Also, because most corporate defendants are likely to want a DPA, corporate defendants needing one may be willing to accept novel probation conditions to obtain one.

Are there valid arguments against such a probation condition (at least where the facts suggest less than adequate internal monitoring and compliance)? First, is it unfair? Certainly, it is less unfair than imposing high penalties in criminal or civil actions that fall on shareholders, creditors, and others. The organizational distance between those convicted and these executives is much closer than in the case of shareholders, and the executives so penalized will usually have at least some degree of culpability. Second, will it cause perverse effects? Some have responded that it might cause a migration of valuable executives away from the firm to greener pastures elsewhere where they could receive incentive compensation. This response assumes that executives at convicted firms are highly mobile. In fact, economic theory suggests that executives have firm-specific human capital that they cannot take with them (and so are likely more valuable to their own firm than to other firms).<sup>60</sup>

A key point here is that this sanction affects corporate officers and employees who are not in the direct chain of command over the junior employees who have committed a crime. Absent such a sanction, such non-supervisory personnel would have little reason to turn in (or report up the ladder) such an employee or even to discourage him from engaging in reckless behavior. A vague sense of loyalty to their fellow employee may also restrain them, but once their own economic position is threatened, this attitude will likely change.

One practical problem does surround this proposal: prosecutors may not have the leverage to insist on it. It may be that prosecutors need the DPA even more than defendants because they simply do not have the manpower or budget to investigate a large multinational case. If so, a defense counsel may refuse to agree to a DPA that restricts incentive compensation (or that otherwise has real teeth), forcing prosecutors to indict in a case where they lack all the facts. In the past, defense counsel similarly refused to agree to DPAs, unless they were promised that no executives would be indicted. In response, the

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60. Executives are not perfectly mobile, and a substantial component of the human capital of any executive consists of the ability to work within a particular system of procedures and within a particular corporate culture. This implies that their human capital may not equip them as well for a different business model or culture. For an overview, see generally Charles M. Elson & Craig K. Ferrere, *Executive Superstars, Peer Groups and Overcompensation: Cause, Effect, and Solution*, 38 J. CORP. L. 487 (2013). This does not deny that there are some superstars (say, traders in a particular market) who may be very mobile. Still, persons seeking to migrate from a convicted corporation may find that they carry a taint and may be viewed with suspicion by other corporations who fear that their departure was at least partly attributable to their involvement in the crime.

Obama Administration adopted the Yates Memorandum, which denied U.S. Attorneys the power to give such assurances of no individual prosecutions.<sup>61</sup> A similar response may be needed here, but it is unclear whether such a policy can be adequately enforced.<sup>62</sup> A strong statement, similar to the Yates Memorandum, could require prosecutors in corporate cases to consider whether probationary conditions designed to encourage a more law-compliant culture and prevent recidivism would be useful.

### B. The Equity Fine.

This article has repeatedly asserted that cash fines are often ineffective because they can be absorbed as a cost of doing business by the defendant corporation. If this were all there was to the problem, the answer would be obvious: greatly increase the firms that are authorized and similarly enhance sentencing guidelines. But there is another side to this coin: large fines can create negative externalities, as the corporation may be forced (or may itself threaten) to close plants, lay off employees, or reduce services. This author has referred to this as the “overspill” problem: penalties fall not only on the shareholders (who at least typically benefitted from the crime) but also on other, more “innocent” constituencies, such as employees, creditors, local communities, pensioners, etc.<sup>63</sup>

Yet, there is a simple answer to this problem: if exemplary fines were imposed not in cash, but in stock, they would have no impact on the corporation’s cash flow. Creditors and employees would thus be unaffected, and the corporation could continue to produce the same goods and services at more or less the same prices. Shareholders would be painfully diluted, but the cost of deterrence has to fall somewhere. The legislation adopting such a penalty could also specify an outer limit and governing criteria (for example, the equity fine could be no greater than double the gain received or the loss caused to victims). In any event, the Eighth Amendment’s “excess fines” clause would enable courts to overturn disproportionate penalties.<sup>64</sup>

How would this penalty work? The sentencing court would require a convicted corporation to issue such number of shares to a crime victim compensation fund as would have an expected market value equal to the cash fine that would have been necessary to deter the illegal activity (i.e., to cancel the expected gain). Thus, if a mid-sized public

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61. Moreover, it followed some political embarrassments for the Obama Administration over the absence of any prosecutions of major financial executives following the 2008 crisis. See Memorandum from Sally Q. Yates, Deputy Att’y Gen., U.S. Dept. of Just., on Individual Accountability for Corporate Wrongdoing to All U.S. Att’ys (Sept. 9, 2015), <https://www.justice.gov/archives/dag/file/769036/download> [<https://perma.cc/ZW7D-54PZ>]. The Yates Memorandum sharply restricted the ability of federal prosecutors to agree not to prosecute corporate executives in return for their corporation’s entry into a Deferred Prosecution Agreement. See also Matt Apuzzo & Ben Protess, *Justice Department Sets Sights on Wall Street Executives*, N.Y. TIMES (Sept. 9, 2015), <https://www.nytimes.com/2015/09/10/us/politics/new-justice-dept-rules-aimed-at-prosecuting-corporate-executives.html> [<https://perma.cc/WV7Y-4YBW>] (explaining that the Yates Memorandum was the DOJ response to criticism that it coddles wall street). The Yates Memorandum was later materially watered down during the Trump Administration.

62. DPAs are ultimately bargained compromises in which each side gains something. If the government makes new demands, some companies may resist settling, hoping that the government will realize in time that it cannot prosecute every case and will eventually compromise on some other point.

63. See John C. Coffee, Jr., “No Soul to Damn: No Body to Kick”: An Unscandalized Inquiry Into the Problem of Corporate Punishment, 79 MICH. L. REV. 386, 413–14 (1981).

64. U.S. CONST. amend. VIII; see *supra* note 52 and accompanying text.

corporation had a market capitalization (before publicity about the crime broke) of \$20 billion and the court wanted to impose an equity fine of \$4 billion (or 20%), of the corporation's shares, it would require that shares amounting to 20% of the outstanding shares after this penalty is imposed be issued to a crime victim compensation fund. The trustee of the fund would operate as a normal fiduciary and thus would be under a duty to diversify its portfolio; thus, this proposal does not contemplate that the compensation fund would be in a position to run the corporation for an indefinite period. The trustee would liquidate the fund's assets to pay restitution to victims; in contrast to a class action, this would involve less delay and less cost.<sup>65</sup> The result is to dilute the shareholders but not affect the corporation's creditworthiness (whereas a cash fine does deplete the corporation's assets and increase its leverage). Because the corporation may have insufficient authorized shares to issue such a distribution, the statute authorizing the equity fine would also amend the state's corporation code to allow the sentencing court to increase the number of authorized shares and approve the issuance, pursuant to the state's "reserved power."<sup>66</sup>

Since this author first made this proposal decades ago, it has attracted academic attention, and several nations, including Scotland and Australia, have formally studied it and even drafted legislation. But no step in its direction has been taken (or is even likely) in the United States, where the recent debate has been dominated by those who doubt that corporate criminal liability makes sense and fear overdeterrence.<sup>67</sup> Nonetheless, the idea makes more sense every day. When the equity fine was first proposed, individual shareholders owned the majority of the stock in public corporation shares. Those shareholders would feel considerable pain upon the imposition of an equity fine while still preserving the difficulty of changing management. Today, as earlier noted, a high majority of a large public corporation's stock is owned by giant diversified institutions (such as the Big Three), who would broadly spread the penalty evenly and who could take effective action to curb or replace management.

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65. A class action might continue for years before being resolved, and the successful plaintiff's attorneys would typically seek a fee from the fund for their services of between 25% and 30%. The fund would ideally be created to cover all victim compensation claims based on criminal corporate behavior so that the excess recovered in one case under an equity fine would be paid out to other claimants in cases where the corporation became insolvent.

66. Some may object that the state cannot change the corporate charter in this after-the-fact fashion on the ground that this would violate the rule first announced in *Trustees of Dartmouth College v. Woodward*, 17 U.S. 518 (1819), that a corporate charter is a contract whose obligations the state may not infringe or modify. But today, this is no longer true for two distinct reasons: First, under the interpretation advanced by Justice Story in *Dartmouth College*, 17 U.S. at 712, the state can enact a "reserved power" in its corporation statute, giving the state the right to subsequently limit, condition, modify, or otherwise change the terms of its contract with the corporation. As Justice Story explained, the shareholders would take their charter from the state, knowing that it could be modified at any time. Almost all states have adopted such a reserved power. See, e.g., *Polk v. Mut. Rsr. Fund Life Ass'n of N.Y.*, 207 U.S. 310, 326 (1907); *People v. O'Brien*, 18 N.E. 692, 703 (N.Y. 1888) (showing both uphold the reserved power). Second, the Supreme Court has also recognized that the corporate charter is always subject to the state's police power to protect public health and safety. See, e.g., *Bos. Beer Co. v. Massachusetts*, 97 U.S. 25, 29 (1877); *Stone v. Mississippi*, 101 U.S. 814, 819-20 (1879). The state's police power is being exercised in the design and implementation of criminal penalties.

67. One exception to this generalization is Professor V.S. Khanna, who opposes corporate criminal liability in general, but does consider the equity fine preferable to reputational penalties. See Khanna, *supra* note 4, at 1505.

*C. Reforming the Deferred Prosecution Agreement.*

Many would simply abolish the Deferred Prosecution Agreement.<sup>68</sup> But this Article's fear is that complex cases involving the largest corporations might not then be prosecuted, as a small team of prosecutors would fear being overwhelmed by a case "too big to prosecute." Or, they would settle early and cheaply before any internal study revealed the fuller dimensions of the crime. Alternatively, these cases might be resolved by indicting only a junior "rogue employee."<sup>69</sup> Indeed, corporations may knowingly offer up a sacrificial lamb to obtain a DPA.<sup>70</sup> Given defendants' control over the evidence, it follows that if we want to reach upward into the executive ranks, we need a mechanism that can conduct an objective study, interviewing all relevant parties, reviewing all pertinent documents and emails (in whatever language they were written). This is a significant and costly undertaking, well beyond the budget of most U.S. Attorneys' Offices.

But how then can the DPA be structured differently to get results that implicate more than the proverbial "rogue" employee at the bottom of the corporate hierarchy? Here are some minimal elements that could be added, without legislation, to the U.S. Attorney's Manual:

The Manual should require an objective study conducted by an independent law firm having no connection with the defendants be given to the court with such counsel certifying to the court that it (i) interviewed, examined and considered all evidence, documents, or witnesses suggested by the prosecution, and (ii) considered, evaluated, and reported all material facts that were contained in such evidence or documents or of which it otherwise became aware;<sup>71</sup>

The Manual should further require that the choice of the counsel and any accounting firm to conduct this study be jointly made by the prosecutor and the corporation's audit committee, with each having a right to disqualify persons it deemed conflicted or unqualified;<sup>72</sup>

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68. For a comprehensive review of recent criticisms of Deferred Prosecution Agreements and recently proposed legislation (including a draft statute by Senator Elizabeth Warren), see Peter R. Reilly, *Sweetheart Deals, Deferred Prosecution Agreements, and Making a Mockery of the Criminal Justice System*, 50 ARIZ. ST. L.J. 1113 (2018).

69. One never knows, of course, whether the "rogue employee" was a true outlier or only an employee responding to the implicit signals sent by higher-ranking executives within the corporation. Here again, the ratio between truly unfaithful employees and excessively faithful agents (who obey implicit signals) is unknown.

70. For example, to win its Deferred Prosecution Agreement, Boeing offered up Mark A. Forkner, its former chief test pilot, as the person who misled the Federal Aviation Agency and thereby obstructed justice. This was implausible, and the jury acquitted him. See Niraj Chokshi, *Jury Finds Former Boeing Test Pilot Not Guilty of Fraud in 737 Max Case*, N.Y. TIMES (Mar. 24, 2022), <https://www.nytimes.com/2022/03/23/business/boeing-trial-737-max-mark-forkner.html> [<https://perma.cc/J7S3-NFDM>].

71. This is the ideal standard, and it would require separate counsel for the internal investigation and the defense of the case. If this is unrealistic (and some may think it is), the minimum position should be that counsel for this study (1) has no recent association with the defendant and (2) will certify to the court and prosecutors that it is aware of no potentially material fact that has been withheld from its report.

72. This could result in a case where no counsel is acceptable to both sides. But this is unlikely if we assume that both sides want a DPA. A larger problem must also be noted here: If the special counsel conducting the internal investigation is dominated or controlled by the prosecutor, then the investigation will no longer be deemed a private investigation by the company, and it may become the government's investigation, which will mean that

The counsel conducting this investigation should report, not to corporate management, but to the corporation's audit committee, and with no private communications being exchanged between this counsel and the corporation's outside or in-house counsel;<sup>73</sup>

Bluntly, a corporation should not be entitled to a DPA simply because it wants one. One could require that it "self-report" the misconduct, or at the least, that its internal study identifies and implicates a senior corporate official.<sup>74</sup> If only low-ranking employees can be identified,<sup>75</sup> the corporation should still be indicted, but its cooperation could be an important sentencing consideration.

Giving up a low-ranking employee or employees does not justify giving the corporation relative immunity from collateral civil litigation or letting it escape the public humiliation of a guilty plea in open court. A DPA should be a reward for diligently following the case up the corporate ladder and identifying a more senior official—and not the product of a default rule, as it is today.

Admittedly, these rules would create considerable uncertainty for the defendant corporation; it could spend millions of dollars on an internal study and still not get the lesser disposition that it wants. But that creates exactly the needed incentive for the corporate defendant to disclose more and even give up a senior executive to save its own skin.

What would motivate a defendant corporation to conduct an internal study—costing possibly \$10 to \$30 million or more—without the assurance of a lenient disposition? Unless we can find a plausible motivation, DPA reforms are likely to fail. Three short answers, however, can be given: First, even if the study and results of the investigation are less than satisfactory, the study may still arm the prosecutors and permit them to carry the case forward on their own. Defendants cannot be certain that prosecutors will not by this point have learned enough to complete the investigation on their own. Thus, defendants

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the Fifth Amendment applies. *See generally* United States v. Connolly, No. 16-CR-370, 2019 WL 2125044 (S.D.N.Y. May 2, 2019). In a private investigation, the corporation can require the employee to either "talk or walk"—that is, to answer its questions or be fired. But the government cannot do the same and is subject to the privilege against self-incrimination. *See* Garrity v. New Jersey, 385 U.S. 493, 497–98 (1967). The relevant issue here thus becomes at what point the prosecutor's involvement in the selection of the special counsel makes it a governmental investigation. This issue is beyond the scope of this article, but a distinction can be drawn between involvement in the selection of counsel and control over what counsel does—which would clearly trigger *Garrity* under *Connolly*. *See also* Harry First, *Branch Office of the Prosecutor: The New Role of the Corporation in Business Crime Prosecutions*, 89 N.C. L. REV. 23, 65–81 (2010) (assessing the distinctions between the goals of a prosecutor and corporations, even in "branch-office role" agreements).

73. House counsel has generally subjected to dismissal or reduction in pay of the CEO (and possibly other executives also) and hence cannot be deemed independent of them.

74. This does not mean that the corporation's cooperation and possible self-reporting could not be given recognition entitling it to leniency at sentencing. These factors are already expressed in the sentencing guidelines. *See infra* note 78 and accompanying text.

75. A qualification is needed here: if the prosecution is occurring at the state level, state law may require that the prosecution show that the crime was committed, supervised, or recklessly tolerated by a "high managerial agent," as required by the Model Penal Code. MODEL PENAL CODE § 2.07(1)(c). The states differ widely in terms of whether they adopt this provision from the Model Penal Code—most do not. Christopher R. Green, *Punishing Corporations: A Food-Chain Schizophrenia in Punitive Damages and Criminal Law*, 87 NEB. L. REV. 197, 204–06 (2008) (analyzing state statutes). At the federal level, however, any employee or agent acting within the scope of the agent's normal authority can create liability for the corporation.

cannot safely quit midway if they cannot secure their desired resolution. Second, if prosecutors are armed with an equity fine or other exemplary penalty, the prosecution's leverage grows, and such a potential sanction cannot be as safely risked by defendants. Finally, there are the interests of counsel conducting this study: if defense counsel turns in an inadequate study, such counsel conducting a compromised or under-motivated study might find that its services would not again be approved for a similar role in a field that is rapidly becoming a lucrative (but competitive) mainstay of corporate practice.<sup>76</sup> The economic incentives of the defense counsel conducting these internal investigations are to seek to maintain their professional reputation and thus their eligibility for further business.

#### *D. Sentencing Credits: When Does Leniency Work?*

The United States Sentencing Commission introduced its organizational sentencing guidelines in 1991.<sup>77</sup> Although they significantly increased criminal penalties for corporations, they relied more on the carrot than on the stick by giving large credits off the presumptive sentence if the corporation did any of the following: (i) self-reported the crime (turning itself in before the government was hot on its trail), (ii) adopted an organizational compliance plan (under which the corporation established a system for monitoring its employees to prevent violations of law), or (iii) accepted responsibility and cooperated fully (i.e., pleading guilty and not going to trial).<sup>78</sup>

How have these credits worked? On detection, a majority of corporations (but only a bare majority) do cooperate and do not go to trial.<sup>79</sup> This willingness to settle may reflect that trial itself is punishment for a public corporation, creating adverse publicity and risking

76. To the extent that prosecutors play an increased role in the selection of this special counsel, the desire of defense counsel to maintain their high-quality reputations will only increase.

77. The Sentencing Reform Act established the U.S. Sentencing Commission in 1984, but it was not until 1981 that the Sentencing Commission promulgated guidelines for organizational defendants. These guidelines are set forth in Chapter 8 of the Sentencing Commission's GUIDELINES MANUAL (U.S. SENT'G COMM'N 2018). As a matter of disclosure, this author served as a consultant to the Sentencing Commission in some of these efforts.

78. Chapter 8 of the Sentencing Guidelines Manual broadly states that two factors can justify more lenient treatment of the corporation at sentencing: (i) the existence of an expected compliance and ethics program, and (ii) self-reporting, cooperation, or acceptance of responsibility (which generally means pleading guilty). An "effective compliance program" is one that promotes organizational due diligence to prevent and detect criminal conduct and otherwise promotes an ethical organizational culture. *Id.* § 8B2.1(a). This provision also requires the organization's governing authority to be "knowledgeable" about the control of the program and exercise "reasonable oversight" over its implementation. *Id.* § 8B2.1(b)(2)(a). The compliance program must include monitoring and auditing to detect criminal conduct, periodically evaluate the program's effectiveness, and publish a means by which employees can report misconduct. *Id.* § 8B2.1(b)(5). If an adequate compliance program is in place at the time of the crime, the court may award up to three points off the organization's overall culpability score (unless high-level personnel participated in, condoned, or were willfully ignorant of the offense). *Id.* § 8C2.5(f).

The sentencing credit for self-reporting is greater, and the court may reduce the organization's culpability score by five points if the self-reporting occurred "within a reasonably prompt time" of the organization's becoming aware of the event and "prior to the imminent threat of disclosure or government investigation." *Id.* § 8C2.5(g). Acceptance of responsibility is normally demonstrated by a guilty plea, but perhaps surprisingly, the guidelines provide that it can also be demonstrated by the appearance in court of an executive officer (not necessarily the CEO) at the sentencing hearing. *Id.* § 8C2.5 n.15. This seems too easy.

79. As an illustration, Brandon Garrett found that 51% of public corporations "cooperated" under the sentencing guidelines in 2012. *See* GARRETT, *supra* note 30, at 160.

more reputational loss than a quiet plea bargain.<sup>80</sup> More interestingly, in contrast to this narrow majority that pleads guilty, public corporations have rushed to adopt compliance plans. This is a “no brainer” decision for corporate counsel because they require little work to adopt, and the effort made to implement them need not be great. Yet, by some estimates, they can result in as much as a 95% reduction in the fine.<sup>81</sup> The irony here is that these compliance plans only become relevant when they fail. That is, we only see them close up when the company is convicted and cites its compliance plan to gain mitigation at sentencing. Academic studies have almost uniformly criticized the research on compliance plans, finding these studies generally lacking in rigor because they do not relate compliance plan characteristics to outcomes.<sup>82</sup> In short, the research to date cannot prove that compliance plans work.

That leaves one final area where the sentencing guidelines grant mitigation credit based on the corporation’s behavior: Did it self-report? Did it turn itself in before the government suspected they had a case? Here, a day and night difference exists between self-reporting and compliance plans. Although public corporations have been eager to adopt compliance plans, few ever self-report. Indeed, the U.S. Sentencing Commission reports that from 2009 to 2012, no corporation received such a self-reporting credit, and only five corporations (out of a sample of over 3,000 corporations sentenced under the guidelines) ever received such a credit.<sup>83</sup>

The bottom line then is that sentencing incentives are sufficient to motivate the adoption of compliance plans but fall far short of motivating firms to self-report. No assertion is made here that compliance plans are worthless. Some probably are, but many may be valuable and sincere efforts to establish a system to prevent legal violations. Nonetheless, the law has failed to create a strong enough incentive to convince corporations to self-report or turn in their executives. To date, the law has been successful in convincing firms to adopt low-cost compliance plans of uncertain value. Legal incentives, it appears, can do a little, but not a lot.

What should be done? Ideally, compliance plans should be their own reward, preventing the crime if they work, but receiving no sentencing credit if they fail. Politically, however, it is probably too late in the day to institute such a simpler, more justifiable system. Still, some marginal changes can be suggested: the compliance plan credit should be combined with the credit for cooperating and accepting responsibility. A corporation that goes to trial and does not cooperate should face a high burden in claiming credit for monitoring its employees. Conversely, a company that turns itself in and identifies who

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80. Some social scientists believe that reputational loss exceeds the impact of the financial penalties at sentencing. Karpoff & Lott, *supra* note 35, at 775–85.

81. Pamela H. Bucy, *Corporate Criminal Liability: When Does It Make Sense?*, 46 AM. CRIM. L. REV. 1437, 1443 (2009); UNITED STATES SENTENCING GUIDELINES MANUAL, *supra* note 59, at 8, introductory cmt.

82. See, e.g., Chen Hui & Eugene Soltis, *Why Compliance Programs Fail and How to Fix Them*, 96 HARV. BUS. REV. 115 (2018); see generally Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487 (2003); Marie McKendall, Beverly DeMarr & Catherine Jones-Rikkens, *Ethical Compliance Programs and Corporate Illegality: Testing the Assumptions of the Corporate Sentencing Guidelines*, 37 J. BUS. ETHICS 367 (2002); Christine Parker & Vibeke Lehmann Nielsen, *Corporate Compliance Systems: Could They Make Any Difference?*, 41 ADMIN. & SOC’Y 3 (2009); James Weber & David M. Wasieleski, *Corporate Ethics and Compliance Programs: A Report, Analysis, and Critique*, 112 J. BUS. ETHICS 609 (2013).

83. GARRETT, *supra* note 30, at 159–60. Professor Garrett also estimates that roughly 3% of corporate defendants did self-report in 2012. *Id.* at 160.

was responsible within it may deserve more than a sentencing credit and could even be granted immunity from criminal prosecution. This has long been the position of the Antitrust Division of the Department of Justice, which grants immunity from antitrust charges in cases involving an alleged conspiracy (typically price-fixing) to the first company (but only the first company) to turn itself in.<sup>84</sup> In sum, incentives should reward serious acts and ignore self-serving gestures.

#### *E. An Initial Summary.*

None of the foregoing reforms are likely to be adopted in the short term. But this also explains why corporate crime is likely to continue, with respected public corporations entering DPA after DPA as serial recidivists.<sup>85</sup> Of course, not all corporations seek to manipulate the system this cynically, but those that are under pressure (whether from rival companies or activist hedge funds) know that—if they get caught—they can still negotiate and obtain DPAs, possibly even while still in the probationary period of their last DPA. They also know that even a large fine is unlikely to affect their stock price much. Finally, senior managers know that as long as they can maintain a position of plausible deniability, they face little risk of individual criminal liability.

### IV. CONCLUSION

This Article has sought to introduce some new ideas into a long-running debate. Chief among these is its assertion that, from a deterrence perspective, the least utilized and most overlooked leverage point is the senior management team that runs the public corporation. Financial penalties imposed on the corporation seldom affect the stock price and thus seldom affect them. Although they may deserve to be targeted, the prospect of holding senior managers criminally responsible for fraud offenses is limited because of: (i) the need to prove specific intent, (ii) the dispersion of authority within the large, decentralized firm, and the organizational distance between senior and operational levels; and (iii) the high costs of multiple prosecutions in comparison to the resources of most U.S. Attorneys. Much as we may want prosecutors to pursue high-ranking corporate executives, prosecutors are inevitably constrained by cost, time, and the greater prospect of acquittal in individual cases. In this light, the under-recognized but key role of corporate criminal liability is that it can be used to induce the company to monitor, discipline, and turn in its responsible

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84. Since at least 1983, the Antitrust Division of the Department of Justice has followed a policy under which the first member of a cartel to approach the government, turn itself in, and cooperate to identify other conspirators earns complete immunity (both for itself and its officers and employees) but only one member of any cartel can earn this credit. The available empirical evidence concludes that this hard-nosed strategy has been effective. Joseph Harrington, *When Can We Expect a Corporate Leniency Program to Result in Fewer Cartels*, 58 J.L. & ECON. 417, 418 (2015); see generally N.H. Miller, *Strategic Leniency and Cartel Enforcement*, 99 AM. ECON. REV. 750 (2009). The premise of this policy was that cartels are notoriously difficult to detect and prosecute, and, thus, special incentives were necessary.

85. Much commentary has recently focused on the “fraud epidemic” in the pharmaceutical industry, where major companies, including Merck, GlaxoSmithKline, and Pfizer, have entered into a series of Deferred Prosecution Agreements with the Department of Justice. In Pfizer’s case, the government even noted Pfizer’s recurrent recidivism in granting a DPA before the probation period on its last DPA had expired. Eugene McCarthy, *A Call to Prosecuting Drug Company Fraud as Organized Crime*, 69 SYRACUSE L. REV. 439, 456–59 (2019).

employees who were engaged in criminal behavior. If properly implemented, corporate criminal liability can create a system under which senior managers dare not induce or pressure lower-ranking employees to cut legal corners or “do what it takes” to maximize profits. Put differently, in the absence of corporate criminal liability, the corporation may be more able to motivate its employees to commit or tolerate a crime than the state can deter these same employees through legal threats.<sup>86</sup>

Even if corporate criminal liability makes sense, there is little reason to believe that our current system creates incentives that produce desirable outcomes. Rather, the legal landscape looks at least as if it were designed by lobbyists to minimize the pain for corporate defendants. Sentencing credits for corporate compliance plans are virtually automatic. Senior managers, as a practical matter, face little risk of liability when they avert their gaze to tolerate non-compliance. Lurking in the background is the possibility that the rate of corporate malfeasance may be far higher than anyone has publicly suggested.<sup>87</sup> What could change this? If public corporations were subjected to higher actual liability, this strategy of tolerating noncompliance might become less viable. Under a properly designed system, both the corporation and its senior managers should be given strong incentives to turn the other in, thus creating uncertainty and competition between them—indeed, something approaching the classic “prisoner’s dilemma.”<sup>88</sup>

Properly implemented, the key virtue of corporate criminal liability is that it can check the ability of the corporate entity to pressure its own employees in low-visibility ways. Absent corporate criminal liability, senior managers can find low-visibility ways to threaten or reward their juniors to run legal risks. Will they all do this? Of course not; individuals differ, and many compliance programs are sincere efforts to prevent crime. But the pressure from activist shareholders for greater profits, the pressure of competition from rivals, and the deep-rooted tendency towards leniency already built into our existing sentencing system leave many companies and managers able to exploit this opportunity.

Reform requires that the corporate entity be incentivized to turn in its managers and executives to protect its own interests (not those of its senior managers, who are typically facing at least a potential risk of prosecution). One path to this end would be a greater reward for self-reporting and a lesser award for simply adopting a compliance plan.

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86. Yes, it is, of course, worse to go to prison than lose one’s job, but one must also consider the relative probability of the two outcomes. The probability of employment termination by the corporation is much higher than that of a criminal prosecution by the state. Some may argue that civil sanctions can equally well induce the corporation to monitor its employees. But this ignores that the criminal sanction inherently includes a much greater reputational penalty, and so is a more effective deterrent (and with less overspill) than a civil fine.

87. See Soltes, *supra* note 46 and accompanying text (discussing research of Harvard Business Professor Eugene Soltes). Professor Soltes finds that the firm’s internal records indicate that large firms uncover information suggesting two instances of malfeasance per week per firm. This would come to 104 such instances a year per firm. This would suggest that internal compliance programs, which receive significant leniency credit at sentencing, are not working adequately, even if they are celebrated constantly in legal literature written largely by defense counsel.

88. I emphasize this point at length in a recent book. COFFEE, *supra* note 33, at 77–83. However, I recognize that, in the classic prisoner’s dilemma, the two defendants cannot communicate, whereas, in the corporate setting, they probably can. Thus, it is important that the corporation’s audit committee be given control over the negotiations because it is less likely to be willing to strike a collusive deal. The hope is that under pressure and less able to collude, the corporate defendant may decide to seek the credit for self-reporting and turn itself in, cooperating against senior officers. Only the audit committee would be independent and distant enough to exercise this option in most cases.

Corporate criminal liability serves a useful purpose only if it motivates internal monitoring and causes the corporate entity to disavow any implicit understanding with its senior managers under which they will protect each other. Today, corporations and senior managers seem to be wedded in a marriage of convenience that prevents this and thereby often injures other stakeholders. Ideally, prosecutors need to be able to play the one against the other. That day is still, however, in the distant future.