

Corporate Criminal Law, Cooperative Regulation and the Parting of Paths*

by

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Introduction

It cannot be denied that the rapid development of the United States, which has astounded the world, has been largely due to combinations of individual wealth collected in large corporations for the purposes of enterprise. We owe much as a new country to them, but it is also true that as a country develops more fully, becomes more thickly settled and the individuals accumulate more wealth, the corporations seek to overstep the bounds of their charters and the laws of the country, and commit crimes.¹

Over a hundred years ago, Judge Cicero J. Lindley admonished members of the States Attorney's Association of Illinois to consider an emerging threat that will only increase as commercial life in the United States matures. Concentrated private wealth, large corporate conglomerates, and the prospect of intense commercial activity in interstate commerce, combine to pose a distinct challenge to law and law enforcement. Add to this the appearance of large trusts, powerful monopolies, and widespread corruption in certain industries. It is no

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¹ CICERO J. LINDLEY (1899), "Criminal Acts of Corporations and Their Punishment", 7 *Am. Lawyer*, 564.

wonder that courts and legislatures regularly debated how best to control abuses of corporate power.

Lindley's words came at a distinct turning point in the history of the criminal law. By the beginning of the Twentieth Century courts were frequently hearing cases of corporate nuisance and corporate misfeasance with a common law heritage that, for reasons having much to do with conceptions of corporate personhood, did not contemplate a role for the criminal law.² It soon became clear, however, that the metaphysics of personhood was an insufficient obstacle. Logic and the absence of biology gave way to the necessity of criminal regulation, or at least the perception of its necessity.³

As Justice Day reasoned in the 1909 watershed case of *New York Central Railroad*, corporations make up much of the activity in interstate commerce. Restricting the criminal law in the regulation of interstate commerce would essentially immunize corporations and "virtually take away the only means of effectually controlling the subject matter and correcting the abuses aimed at it."⁴ With *New York Central Railroad*, the corporate criminal law was elevated above failed regulatory policies and practices. In the ensuing years, however, the divergence between the literal requirements of *New York Central Railroad* and actual regulatory practice grew dramatically. How and why this divergence took place will be briefly discussed in Part I of this paper.

It would be a misstatement to conclude, however, that the corporate criminal law and, thus, corporate criminal liability, became something of a relic. Resort to the criminal law moved in an out of favor over the past Century. In recent years, the conventional wisdom endorses the coexistence of cooperative models of regulation and corporate criminal

² See, e.g., KATHLEEN F. BRICKEY, (1984), *Corporate Criminal Liability*.

³ See, STEVEN D. WALT & WILLIAM S. LAUFER, (1991), "Why Personhood Doesn't Matter: Corporate Criminal Liability and Sanctions", 18 *Am. J. Crim. L.* 263; STEVEN D. WALT and WILLIAM S. LAUFER, *Corporate Criminal Liability and the Comparative Mix of Sanctions*, in *White Collar Crime Reconsidered*, ed. Kip Schlegel and David Weisburd (1992). For a lively debate on corporate personhood, see DONALD R. CRESSEY (1988), "The Poverty of Theory in Corporate Crime Research", in 1 *Advances in Criminological Theory* 31; JOHN BRAITHWAITE and BRENT FISSE, (1990), "On the Plausibility of Corporate Crime Control", 2 in *Advances in Criminological Theory* 15; and GILBERT GEIS, (1994), "A Review, Rebuttal, and Reconciliation of Cressey and Braithwaite & Fisse on Criminological Theory and Corporate Crime", 5 in *Advances in Criminological Theory*, 321.

⁴ *New York Central & Hudson River Railroad Company v. United States*, (1909), 212 U.S. 481.

liability where resort to the criminal law is literally the last resort.⁵ In Part II of this paper, we raise one of a number of limitations that plague this coexistence. Scholars have recognized the theoretical risks and limitations of complete reliance on the criminal law. Others have documented the distinct weaknesses of cooperative regulation. We restrict our discussion to the difficulties of protecting "blended" regulatory regimes from corporate abuses or "gaming".

Finally, we conclude that the evolution away from reliance on criminal law and command and control regulatory strategies in recent years requires either abiding faith in the character of compliance or, alternatively, a disinterested vigilance to ensure its integrity. We deny having the former and question, albeit optimistically, how this vigilance might be achieved when the interests of regulators and the regulated are so much aligned.

I. Phases of Corporate Criminal Law

The corporate criminal law has moved through four distinct phases. In the first phase, courts obsessed over the importance and meaning of corporate personhood. The individualistic bias of common law crimes made the attribution of liability seem both strange and wrong. Courts could only go so far. Without a soul, judges concluded that the idea of corporate *mens rea* was too much of a fiction. Between 1850 and 1910, however, rising concerns over new forms of market power and rapid market integration captured the public's attention. Corporate criminal liability, no matter how illusory or seemingly illogical, became increasingly appealing as a hedge against this power.

In the second phase, initiated by the decision of *New York Central Railroad*, courts abandoned the nonfeasance-misfeasance distinction for reasons of practicality.⁶ Corporate regulation this new world of interstate commerce necessitated a powerful and more formal social

⁵ See JOHN BRAITHWAITE, (1990), "Convergence in Models of Regulatory Strategy", 2 in *Current Issue Crim. Just.* 59; see also I. AYRES & J. BRAITHWAITE, (1992), *Responsive Regulation: Transcending the Deregulation Debate* (articulating a new paradigm for regulatory cooperation); J. BRAITHWAITE, (1985), *To Punish or Persuade: Enforcement of Coal Mine Safety* (extending theories of self-regulation to the coal industry); JOHN BRAITHWAITE, (1982), "Enforced Self-Regulation: A New Strategy for Corporate Crime Control", 80 *Mich. L. Rev.* 1466 (proposing a new concept of regulatory cooperation).

⁶ WILLIAM S. LAUFER, (1994), "Corporate Bodies and Guilty Minds", 43 *Emory L.J.* 647, 651-58 (discussing origins of corporate criminal liability).

control. This was all the more true as the first merger wave ended and large corporations became increasingly decentralized. Centralized functions were now specialized and complex. In the years leading up to *New York Central Railroad* unease over loss of control across the managerial hierarchy invited the formality of criminal law.⁷ Vicarious corporate criminal liability soon became the rule of law in all federal courts.

The phase that began with a set of clearly defined liability rules, derived from the tort law doctrine of *respondeat superior*, evolved into a protracted period of strategic risk shifting by employers and employees. Perceptions that vicarious fault was unduly strict and harsh prompted pleas by firms for a better understanding of the complexity of the corporate form and the diligence of management in promoting law abidance.⁸ No fewer than four years after *New York Central Railroad*, corporations were raising due diligence defenses. One cannot imagine a greater slight to the substantive law. How can corporations assume risks for the acts of their agents and, yet, avoid liability if they did their best to ensure compliance. A host of other risk shifting mechanisms, from fidelity bonds and a variety of other insurance products, characterized the liability posturing of both employers and employees.

This posturing continued into the third phase distinct phase of the corporate criminal law, where there was a marked rise in regulatory power and regulatory law. Compliance replaced punishment as the preferred sanction in a regulatory era where the locus of enforcement was found in sweeping legislation, codified in a host of federal and state regulatory statutes. Labeled the Environmental-Consumerist Period by legal scholars, Congress and state legislatures turned their attention to "social costs of a successful industrial economy"⁹. By the end of this period, and the beginning of a subsequent phase of deregulation, literally thousands of criminal provisions were found in a wide range of federal statutory law.¹⁰ Marshall Clinard and his colleagues captured a glimpse of the effects of this new regulatory state on large corporations in their much-heralded work *Illegal Corporate Behavior*.¹¹

⁷ See generally R.S. GRUNER, (1994), *Corporate Crime and Sentencing*.

⁸ W.S. LAUFER, (1999), "Corporate Liability, Risk Shifting, and the Paradox of Compliance", 52 *Vand. L. Rev.*, 1343.

⁹ H. FIRST, (1990), *Business Crimes* 4.

¹⁰ LAUFER W.S. (1992), "Culpability and the Sentencing of Corporations", 71 *Neb. L. Rev.*, 1049.

¹¹ CLINARD M., YEAGER P.C., BRISSETTE J., PETRASHEK D., and HARRIES E. (1979), *Illegal Corporate Behavior*.

In the final and present phase, spurred by the passage of the Sentencing Guidelines for Organizations, corporations were seduced into a novel partnership with government. Following significant lobbying from business associations, a congressionally appointed body – the United States Sentencing Commission – announced guidelines that govern the sentencing of corporations in federal courts. The timing of the release of the Sentencing Guidelines could not have been better. Congress approved the Sentencing Guidelines when dissatisfaction with the remaining command and control strategies of corporate regulation was paramount. Drafters of the Sentencing Guidelines wanted corporations to face the threat of significant punishment and, at the same time, the possibility of mitigation, leniency, and amnesty. Theories of cooperative regulation and negotiated compliance, blended theories, could easily accommodate.

The Sentencing Guidelines require judges to consider a base fine multiplied by a mitigation score. A corporation's willingness to accept responsibility, cooperate with authorities, and implement a compliance plan reveal due diligence. Of course, knowing the Sentencing Guidelines prescription for organizational due diligence in advance gives corporations incentive to demonstrate compliance so that, in the very unlikely event of a criminal investigation, liability is avoided or at least minimized. None of this logic was lost on a cottage industry of consultancies that soon after the passage of the Sentencing Guidelines turned corporate compliance into a large and, at least initially, profitable industry – all in the name of the Good Corporate Citizenship movement.

The compliance industry deftly markets the story that evidence of organizational due diligence likely forestalls a criminal investigation, minimizes the likelihood of a criminal indictment, and regularly leads to a grant of governmental leniency, if not amnesty. Regulators and prosecutors decline cases involving corporations that demonstrate a commitment to compliance and actively cooperate with authorities. Declinations reward firms for their proactive, reactive, and cooperative efforts, reserving resources for the most abusive firms.

Policy statements issued by the largest regulatory agencies reinforce the move away from command and control strategies to a brand of negotiated compliance, coerced cooperation, and regulatory persuasion. Most offer generous leniency and amnesty programs for corporate cooperators. Organizational cooperation and acceptance of responsibility are exchanged by corporations for mitigation, exculpation, or absolution. In fact, corporations have little choice but to trade favors with authorities with the threat of significant Guideline-prescribed fines.

The result is a new enforcement landscape – one of substantial assistance, mitigation credits, and voluntary disclosure. In theory, the substantive corporate criminal law is unchanged since *New York Central & Hudson River Railroad*. In practice, negotiated compliance has all but replaced the substantive law. Corporate cooperation that facilitates the flow of evidence to authorities is the critical feature of this regulatory strategy.

II. Gaming the Partnership

Critics of cooperative models credit their ineffectiveness to a combination of "structural constraints of regulatory agencies and the ideological, political, and economic consequences of these constraints."¹² Others focus on the inevitability of collusion and ask, "Who controls the controllers?"¹³ We ask similar questions. Our focus, however, is on the effects of gaming "blended" regimes, particularly when regulatory incentives align corporate and governmental interests and create a partnership. The motives behind the creation of this partnership were entirely transparent.

"The Guidelines' carrot and stick approach," according to a former United States Attorney, "represents an unprecedented offer by the government for business to become the government's "partner" in controlling crime".¹⁴ This partnership is designed to increase compliance with laws and regulation; support proactive approaches to preventing unethical and illegal acts; open lines of communication about compliance concerns and failures; and align the interests of government with those of business.

Can this partnership ever be too close? In what ways may corporations exploit this partnership to further shift liability risks? One disturbing trend, "Reverse whistleblowing" (RWB), provides answers to both of these questions. RWB is a risk shifting game, occurs when an organization, through the actions of senior management, identifies culpable employees and offers evidence against them in a trade with prosecutors for corporate leniency or possible amnesty. RWB is the inverse of the familiar practice of employee whistleblowing. Instead of

¹² L. SNIDER, (1995), "Regulating Corporate Behavior", in M.B. BLANKENSHIP, *Understanding Corporate Criminality*, p. 202.

¹³ G. VAN DEN HEUVEL, *Corporate Crimes in the East and West: In Search of 'Collusion'*.

¹⁴ O.G. OBERMAIER, "A Practical Partnership," *National Law Journal*, Nov. 11, 1991, at p.13.

employees identifying corporate deviance, the practice of RWB identifies deviant employees. In law abiding organizations, RWB is often justified as a strategy necessary for survival. Unfortunately, however, corporations that share culpability practice RWB to displace blame.

In the consensual form of RWB, or consensual "scapegoating," a corporate agent willingly takes responsibility for a "corporate" wrong. In the more disturbing nonconsensual form, credible though not entirely deserving agents are blamed. In both cases, RWB is rationalized as a necessary compromise to maintain the viability and health of the entity. In both cases, RWB often produces a divergence of interests between management and employees that inevitably leads to actions that appear far less than fair, such as the scapegoating of subordinate employees for the acts of the company.

The concern is that subordinate employees with a peripheral connection to organizational deviance will be treated as expendable, particularly when corporate counsel and regulators begin bargaining over criminal liability. "Corporations, if left to their own devices," according to Brent Fisse and John Braithwaite, "will try to deflect responsibility to a select group of sacrificial personnel, often at a lower level than the actual source of skullduggery."¹⁵

Blaming subordinates may be nothing more than shielding senior managers and the entity from criminal liability. Harsh and unjustified discipline of employees may be practiced only to satisfy perceptions of Guidelines' compliance. The focus on securing evidence of wrongdoing routinely compromises the rights of employees, including the right against self-incrimination. Prosecutors are known to have coerced employers to pressure suspected employees. Concerns over waivers of attorney-client privilege chill internal investigations. The mad dash to the prosecutor's office by organizations to self-report can compromise the quality of information tendered. Finally, all of this has led to a discernable shift in the role of corporate counsel, from employee advocate to government agent or informant

Five factors determine whether the practice of RWB raise fundamental questions of fairness? First, the relationship between the criminal act alleged and the actions of the entity. The greatest risk lies where a significant connection exists between the acts of an employee and the actions (or inactions) of the entity converge. For example, fairness concerns are magnified where top management is complicit or

¹⁵ B. FISSE & J. BRAITHWAITE J., (1983), *Corporations, Crime and Accountability*, p.29.

where middle management tacitly encourages employees.

Organizations that are tightly coupled face increased risks of criminal liability. Corporations tend toward decentralized, divisionalized, loosely coupled structures as they mature in size and specialization. This evolution, some claim, "allows the corporation to take advantage of opportunities as they arise and react quickly to threats, in and from the task environment. It also allows the organization to distance itself from illegal actions, illegal actors, and undesirable attention."¹⁶ Determining a significant connection between the actions of the corporation and an employee's act, therefore, is often extremely difficult. Loosely coupled organizations are well designed to scapegoat employees without detection.

Second, fairness concerns raise the extent to which officers, senior executives, and senior managers condoned the commission of the offense or knew or consciously disregarded knowledge of the illegality. Where senior managers instructed others to commit the offense, were aware of the illegalities, or consciously disregarded the commission of the offense, the risk is greatest. This state of mind variable, like the action variable discussed above, is related to firm size and decentralization. Evidence of corporate knowledge or action is much more difficult to obtain in organizations where decision making is tied to an informal culture of "nudges and winks, of rules which are not really meant to be obeyed".¹⁷

A third variable is the relationship of offending employees to those cooperating with the government. Fairness concerns are greatest where the status of the employee being investigated or charged is far subordinate to those offering cooperation. The notion of scapegoating requires more than mere substitution; scapegoats must be disposable and worthy of being disposed. Ideally, from the perspective of the corporation, a scapegoat should be weak and unable to retaliate.

Fourth, the character and quality of compliance initiatives are critical. Nonconsensual RWB appears that much more likely in cases where firms purchase compliance to the minimum requirements of prevailing laws – purchases that go to satisfy the impressions of regulators. Finally, the existence of a corporate culture embraced by leadership and committed to organizational integrity minimizes fairness concerns.

¹⁶ C. KEANE, *Loosely Coupled Systems and Unlawful Behaviour: Organization Theory and Corporate Crime*, in "Corporate Crime: Contemporary Debates", 168, 169 (Frank Pearce et al. eds., 1995).

¹⁷ B. FISSE & J. BRAITHWAITE, (1983), *Corporations, Crime and Accountability*, 184.

III. Conclusion

The practice of RWB provides a glimpse of the limitations of a cooperative regulation in a blended regime. It is but one unfortunate artifact of a growing trend to exalt the value of corporate cooperation. What signal is sent to employees when it becomes clear that the loyalties of corporate counsel, outside counsel, and prosecutors continue to converge? The answer seems clear.

Every year following passage of the Sentencing Guidelines, there has been a noticeable escalation in prosecutorial expectations of organizational cooperation—an escalation made public in the criminal investigations of Prudential Securities, Salomon Brothers, and Sequa Corporation. In each case, crimes were ultimately recast as actions of wayward employees, rather than those of the organization after these targeted corporations satisfied prosecutorial demands for cooperation.

The lesson was simple – in the unlikely event that criminal activity is identified in an organization, joining with prosecutors in offering boundless cooperation may very well avert even a near death experience. Without the pressures from this partnership and with unwavering faith in the character of corporate compliance, no one would doubt the integrity of blended cooperative regimes. But the pressures are real and the metrics for assessing corporate compliance are far from perfect.

To address the pressures and the prospects of gaming, there appears one simple solution: increase organizational transparency. Braithwaite's notion of tripartism and Shearing's model of constitutive regulation leverage the power and place of consumer lobbies, unions, and nongovernmental organizations.¹⁸ Third party participation in the regulatory process may be the most elegant solution to ensure a true compliance and, yet, genuinely combat deviance. Proposals to leverage public interest groups and their capability to more formally monitor the regulated and regulators may hold the greatest promise.

RÉSUMÉ

La croyance populaire sanctionne depuis quelques années la coexistence de modèles de réglementation coopératifs et de

¹⁸ See AYRES & BRAITHWAITE, *supra* note 7, at 54 ("[T]ripartism might prevent harmful capture, identify and encourage efficient capture, enhance the attainment of regulatory goals, and strengthen democracy.").

responsabilité criminelle des entreprises lorsque le recours au droit criminel est littéralement le dernier recours. Dans cet article, nous soulevons une des nombreuses limitations qui contrarient cette coexistence. Les experts ont reconnu les risques et les limitations théoriques que comporte le fait de s'en remettre entièrement au droit criminel. D'autres ont documenté les nettes faiblesses de la réglementation coopérative. Nous discuterons de la difficulté de protéger les régimes de réglementations "mixtes" des abus de l'entreprise, ou "ganring". Nous concluons que le fait de compter de moins en moins sur le droit criminel ainsi que les stratégies de réglementation du commandement et du contrôle mises en places ces dernières années requièrent soit une foi constante dans le respect desdites réglementations, soit un observatoire désintéressé pour en assurer l'intégrité. Nous nions disposer de cette foi, et nous nous demandons, serait-ce par excès d'optimisme, de quelle manière cette vigilance pourrait être mise en place alors que les intérêts de ceux qui réglementent sont aussi fortement alignés sur les intérêts de ceux qui sont réglementés.

RESUMEN

En los últimos años, el saber convencional confirma la coexistencia de modelos de reglamento cooperativos y responsabilidad penal societaria donde no se recurre al derecho penal más que en última instancia. En este documento mencionaremos una de las muchas limitaciones de las que está plagada esta coexistencia. Los especialistas han reconocido los riesgos y limitaciones teóricas que conlleva una dependencia absoluta del derecho penal. Otros han documentado la marcada debilidad del reglamento de cooperativas. Discutimos acerca de la dificultad de proteger regímenes reglamentarios "combinados" de los abusos societarios o "gaming", y llegamos a la conclusión de que la evolución al margen de la dependencia del derecho penal y las estrategias reglamentarias de mando y control de los últimos años exige una fe permanente en el cumplimiento de los mismos o, como alternativa, una vigilancia desinteresada para asegurar su integridad. Negamos poseer la primera y nos preguntamos, aunque con optimismo, cómo puede lograrse esa vigilancia, cuando los intereses de quienes dictan los reglamentos y los de quienes son el objeto de los mismos convergen tanto.