

*If politically powerful corporations feared corporate crime laws, then why are so many statutes on the books?*

# Politics and Corporate Crime Legislation

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**C**ORPORATE CRIME IS BACK IN THE NEWS. The last few years saw some of the most spectacular revelations of corporate wrongdoing in U.S. history and led to the passage of the Sarbanes-Oxley Act of 2002. This legislation added to the already sprawling realm of corporate criminal liability. Indeed, even before Sarbanes-Oxley, the estimated number of federal criminal offenses for which a corporation could be convicted was well over 300,000. The laws cover a wide range of areas such as environmental, securities, banking, and antitrust violations. With such tremendous breadth and so many new measures being debated and enacted, now seems an appropriate time to think more broadly about how we might better regulate behavior in the corporate sphere.

Legal scholarship has examined many aspects of the imposition of criminal liability on corporate entities, but some fundamental questions remain largely unanswered. In particular, how did so much corporate crime legislation get enacted, given the lobbying strength of corporate interests? We would expect that wealthy, organized corporations would largely be able to get their way in the legislative process, yet they appear to be losing the battle over corporate crime legislation. How can we explain that outcome?

## TRADITIONAL ACCOUNTS

Let us begin with a potential public choice explanation. Cor-

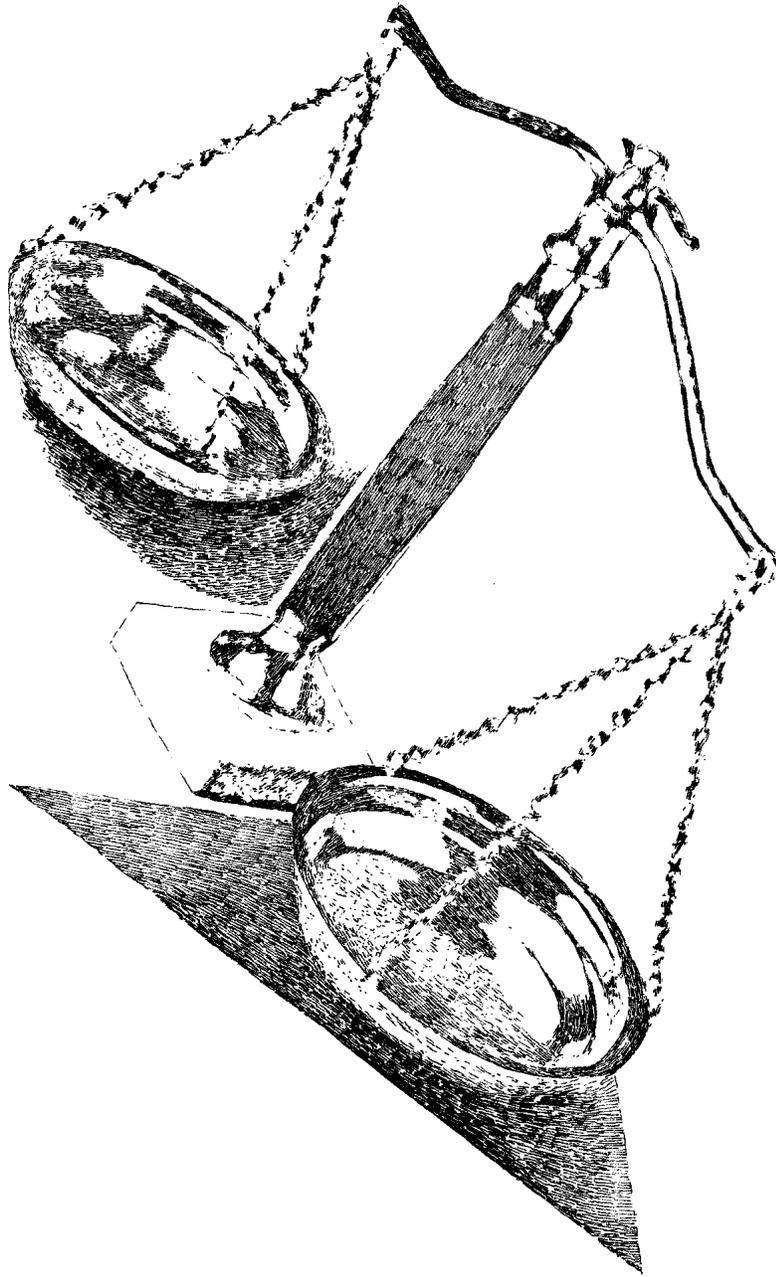
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porate crime legislation may benefit some incumbent firms by raising competitors' costs for entering or remaining in business. Entrenched incumbents would thus benefit from reduced competition, and would be inclined to lobby for such legislation.

This explanation is not particularly convincing. First, corporate crime enforcement is infrequent and generally not a large cost to business. This suggests that corporate crime legislation would not provide much of an entry barrier to new firms. Second, there are many instances where small firms (which newer firms tend to be) are treated better under the laws than larger firms. For example, under the organizational sentencing guidelines, smaller corporations are likely to receive smaller fines compared with similarly situated larger firms. This suggests that an entry barrier account is not entirely consistent with the facts.

Moreover, if incumbents wanted to discourage new firms from entering the market, they would not need to use criminal liability. Civil liability would be sufficient, as both criminal and civil liability offer only monetary penalties against corporations and civil liability is both more frequent and often larger. The relatively low cost of corporate criminal liability makes other public choice explanations less plausible as well.

Another possible explanation would be that corporate crime legislation arises because politicians are using the threat of more severe legislation to extract (or extort) rents from corporations. This too seems implausible. The infrequency of enforcement and the small size of the penalties make one doubt the rent extraction potential. Moreover, rent extraction is more likely under corporate civil liability because of its more frequent enforcement



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and larger penalties. Further, if rent extraction were a large concern, we might expect corporate lobbying against such legislation, but we rarely see such corporate opposition.

Finally, one might posit that corporate crime legislation could be in the public interest and that may give it some political strength. To the extent that this claim relies on the notion that such legislation deters corporate wrongdoing, it rests on shaky footing. Earlier studies of the deterrent effect of corporate criminal liability, including my own, find little reason to think that it has much deterrent effect above that associated with corporate civil liability. Indeed, some of my other papers suggest that certain critical aspects of corporate criminal liability are difficult to justify under a deterrence framework (e.g., the requirement of corporate *mens rea*, the increasing of corporate penalties because of top management involvement in wrongdoing).

If the traditional political accounts provide scant explanation

for the growth of corporate crime legislation, then where should we look to next? In the following pages, I suggest that we need to look at more novel explanations.

### THE POLITICAL PUZZLE

To analyze the political dynamics of corporate crime legislation, it is important to recognize that the politics of criminal law (street or white collar) is a story of institutional politics — that is, the politics of the institutions and their players in the criminal context. It then becomes important to examine the incentives of the important players such as Congress, management, corporations, prosecutors, judges, the general public, and crime victims themselves.

To begin, we need a sense of how most corporate crime legislation comes to be enacted. The normal pattern is that there is a large public outcry for greater regulation following the revelation of a number of events of corporate wrongdoing, usually during or around a weak economy. This was the case for the Federal Securities laws, the Foreign Corrupt Practices Act and other legislation surrounding Watergate, insider trading legislation in the mid-1980s, and the recent Sarbanes-Oxley Act. Against this backdrop of increased calls for regulation, Congress must act or else face electoral disaster.

Thus, the issue is what to do. Congress has many options: It could enhance corporate civil liability, corporate criminal liability, liability for third parties (e.g., accountants), managerial criminal liability, direct regulation, or some combination of the above. Which option Con-

gress chooses depends to some extent on the lobbying efforts and incentives of corporate groups and other interested parties. Let us consider some scenarios.

### DO CORPORATIONS PREFER CRIMINAL LIABILITY?

In response to great public outcry, Congress could increase liability for corporations. One option would be for lawmakers to increase corporate civil liability by increasing the kinds of things that are actionable (increasing the number of wrongs) or by increasing the civil penalties that corporations may suffer. On the other hand, Congress could expand corporate civil liability somewhat less, but also criminalize those new wrongs. Which of those options might corporate interests prefer?

**SYMBOLIC MEASURES** Corporate criminal liability appears to have lower expected costs for corporations than increases

in corporate civil liability. That is because both the enforcement and penalties associated with corporate criminal liability are weaker than those associated with corporate civil liability.

Corporate crime enforcement has been quite thin — indeed quite symbolic — with only a few convictions per year. That may be due in part to the limited enforcement budget many prosecutors face and to the presence of strong criminal procedural protections (e.g., beyond reasonable doubt, double jeopardy). Moreover, because the enforcement budget is subject to congressional control, corporations can use lobbyists to influence the level of enforcement by advocating reduced funding. In contrast, corporate civil liability, which is enforced by both government agencies and private litigants, has greater and more frequent enforcement (in part because of the presence of more “enforcers”), has lesser vulnerability to lobbying over enforcement budgets, and is not subjected to the higher criminal procedural protections. Thus, under the civil alternative, corporations face a higher likelihood of being penalized.

Moreover, the penalties in the civil side are usually greater than in the criminal side. The civil side possesses a greater risk of supra-compensatory damages (e.g., punitive damages) than the criminal side. Recent increases in criminal penalties do not alter this analysis because they were accompanied by at least as great an increase in civil sanctions. Thus, corporations would prefer corporate crime legislation because its enforcement is less frequent and its penalties are normally lower than those associated with increases in corporate civil liability.

**TARGETED ENFORCEMENT** We might also expect less frivolous and more targeted enforcement under corporate criminal liability than corporate civil liability. That is because corporate civil liability is enforced by both government (e.g., the Securities and Exchange Commission) as well as private litigants, whereas corporate criminal liability is enforced only by the Department of Justice.

Private litigants are more likely than government agents to bring frivolous suits because private litigants receive direct financial gains from pursuing such suits. Further, given that prosecutors want to maximize convictions and are operating within a budget, we would expect them to devote resources to cases they consider more likely to result in convictions. Presumably, this pushes them to pursue more meritorious cases, which tend to be cases where it is easier to obtain convictions. Things are likely to be different in the private litigation setting under corporate civil liability with class actions, contingency fees, and entrepreneurial attorneys. Thus, corporate interests may prefer less frivolous and costly litigation via corporate crime legislation to more frivolous and costly litigation via increases in corporate civil liability.

**THIRD-PARTY LIABILITY** In civil proceedings, the corporation is not the only party that may be pursued. For example, in a standard securities-law civil suit, the defendants often include the corporation, its officers and directors, its accountants, its attorneys, and its underwriters. In criminal cases, it is more difficult to impose liability on third parties because of the *mens rea* requirements and the higher standard of proof. A lower

chance of third-party liability is valuable to corporations because they often bear a large chunk of the costs associated with such liability. For example, if third parties contract with the corporation in some form (e.g., for accountancy services), then an increased risk of sanctions for third parties would be reflected in higher prices (e.g., higher accounting fees) to the corporation. If the expected cost to third parties is lower under criminal liability than civil liability, then we might expect corporate interests to prefer the lower-cost criminal alternative.

**EXAMPLES** Do we see corporate interests preferring corporate crime legislation over enhancements in corporate civil liability? Let us begin with the most recent series of corporate scandals. One response could have been to repeal the Private Securities Litigation Reform Act of 1995 (PSLRA) and overturn some related U.S. Supreme Court jurisprudence. The PSLRA restricted the scope of private securities fraud liability and, along with the Court precedents, made it harder to impose liability on associated parties (e.g., accountants). That, in turn, partly insulated accountants and issuers from securities fraud liability, thereby reducing the costs associated with securities fraud (for them) and, arguably, increasing the incentive to engage in it. Repealing the PSLRA and overturning associated Court precedent could combat this and would broaden corporate civil liability.

Indeed, advocacy for this change intensified after the Enron collapse. But those efforts ultimately failed and Sarbanes-Oxley was enacted instead. Corporate opposition to Sarbanes-Oxley was considerably less intense than opposition to moves to enhance corporate civil liability through repeal of the PSLRA.

Also, consider the lobbying that surrounded the Foreign Corrupt Practices Act. Corporations opposed the various proposals to require disclosure of payments made to foreign government officials. The disclosure requirements would have imposed a large compliance burden on corporations and a large enforcement cost on the government. In the end, the disclosure requirements did not come to pass and instead we saw an increase in criminal liability. By all accounts, the costs of this criminal liability for business interests are quite small and there was little lobbying over it. Those results could be interpreted as evidence that corporate interests prefer criminalization because it has lower costs than disclosure requirements.

### THE SUBSTITUTION THESIS

Corporate interests may also prefer corporate crime legislation because of its potential effect on the incidence of managerial criminal liability. Corporate criminal liability has the potential to deflect criminal liability away from managers and on to the corporations themselves

For example, having a corporate defendant along with a management defendant in the same case may increase the odds that management escapes conviction or suffers a lesser criminal penalty relative to where management is the only defendant. When there are two sets of defendants (the corporation and the manager), we provide the court with more options of who to hold accountable. The court may then decide to exercise that choice in favor of acquitting managers and convicting

corporations. Why would a court do this? For one reason, the managerial defendant is a real human being who has a family and can go to jail, whereas the corporate defendant cannot go to jail. By only imposing liability on the corporation, the court can hold someone accountable for wrongdoing without sending anyone to jail. That option is not present when there is only a managerial defendant — the choices are either to hold the manager accountable or hold no one accountable. It is then plausible that fewer managers are being convicted when corporate criminal liability is available than when it is not. Does such liability deflection happen? If so, why would corporations not lobby against this?

On the first question, there is case law upholding corporate convictions when all potentially liable agents have been acquitted. Although the legal rationales for this result are interesting, the important point is that these cases arise in the first place. That raises the possibility that liability deflection may occur.

The deflection account is also recognized by prosecutors. The Department of Justice's Principles of Federal Prosecution of Business Organizations warn prosecutors to be cautious when engaging in plea negotiations with corporations, as those corporations may be willing to plead guilty to protect managers from liability. This concern may have led prosecutors to adopt policies designed to induce the corporations to turn over information on potentially culpable agents.

Moreover, as Raymond Atkins and Jeffrey Parker suggested in their 1999 *Journal of Law and Economics* article "Did the Corporate Criminal Sentencing Guidelines Matter?" empirical evidence appears to support (or, at least, not contradict) the deflection thesis. It appears that corporate and individual managerial penalties are coordinated, at least implicitly. If such coordination occurs, then managerial penalties should drop with the presence of corporate co-defendants, which suggests deflection.

Of course, deflection may not occur all the time. If managers are clearly guilty of wrongdoing and have caused serious harm, then juries are more likely to hold them liable. Nonetheless, it is plausible (and likely) that deflection occurs in a number of other instances. If liability deflection occurs via corporate criminal liability, then why might corporations not actively lobby against it?

**DEFLECTION** Corporate criminal liability could benefit firms by shifting criminal liability from managers, who are poor risk-bearers, to corporations, which are better risk-bearers. Managers cannot diversify their investment in the corporation (largely human capital) as easily as shareholders can diversify their investment in the corporation (largely monetary capital). Consequently, managers need to be compensated more than shareholders for bearing risk, which is likely to be reflected in a higher wage. That would lead firms to prefer to bear the risk themselves because that is cheaper than paying managers to bear it. Corporations can do this in civil liability regimes by paying for insurance or indemnification of corporate agents, and thereby effectively take upon themselves the costs of such liability. Similarly, the risk of criminal sanctions is another risk that managers bear poorly for which they need to be, at least implicitly, compensated. Corporations may then prefer to shift some criminal liability away from managers, but managerial

criminal sanctions (especially jail) are difficult to explicitly indemnify or insure against. Corporate criminal liability permits corporations to deflect some liability away from management, thereby reducing their wage bill.

Even if deflection were to lead to greater costs for corporations, then they may still not lobby against it because of agency costs. Corporations cannot lobby by themselves — it is managers and other agents who lobby for corporations. However, because of liability deflection, managers may not want the corporation to lobby against corporate criminal liability.

## **OTHER PLAYERS**

Corporations and executives are not the only important players in this game. Others include Congress, prosecutors, judges, the general public, and victims of crime. Their incentives apparently do not stem the tide toward broader criminalization.

**THE PUBLIC AND VICTIMS** The desires of the general public and victims of wrongdoing for punishing corporate offenders factors into the decisions of the primary players (e.g., Congress and prosecutors) and establishes the boundaries within which the primary players operate. However, because the general public and victims may not be familiar with the details of the corporate criminal law and suffer from collective action problems, one would not expect them, as a general matter, to closely monitor the laws and rules promulgated by legislators.

**CONGRESS** Presumably, legislators want to remain in power and perhaps rise into higher office. For that to happen, they need to please the voters who care deeply about crime, want convictions, and want to feel safe. This creates an incentive for legislators to generate convictions and to take tough stands, frequently symbolic, that fit on the evening news. Legislators could increase the number of convictions by broadening the criminal law to prohibit many more activities because that makes it easier to obtain a conviction, or by increasing sanctions because that increases the threat value of trial, making it easier to obtain guilty pleas. Moreover, the legislature could pass new laws that may not really change the targeted behavior but would still give voters a sense of security that "something is being done." This suggests that legislators would prefer broader criminal law because it helps to curry favor with voters.

**PROSECUTORS** Prosecutors would generally prefer broader criminal law because it enhances their discretion, which should benefit them. For example, elected prosecutors would like broader criminal law because it enhances their ability to take symbolic stands and to provide voters with outcomes (i.e., convictions) they desire. Appointed prosecutors who would like to run for elected office face similar incentives. Moreover, appointed prosecutors who desire to move into higher appointed office will need to do things that provide the "appointers" with a reason to select them for that office. That may involve many things, but will almost certainly involve obtaining convictions the general public desires.

Even if prosecutors are not influenced by such "electoral"

motivations, they still should prefer broader criminal law because it would help to reduce their workloads while still generating convictions. With many crimes applying to essentially the same behavior, the prosecutor could charge all the crimes in one trial and thereby increase the expected sanction the defendant faces from going to trial. That makes going to trial less attractive to the defendant and should induce guilty pleas. A guilty plea generates less work for prosecutors than trials, yet obtains convictions of some kind. Consequently, if prosecutors were to lobby legislators, we would expect them to want broader criminal law.

Of course, broader criminal law may result in the criminalization of certain behaviors considered innocuous by the polity, which could then lead to negative public reaction. However, this concern is muted in the American criminal justice system because of prosecutorial discretion. Prosecutors need not prosecute every case that presents a potential violation of the criminal law. Further, given the desire of many prosecutors to bring suits that the public desires, we expect that only a few prosecutions would deeply offend public sensibilities with unfavorable prosecutions.

Because prosecutors rarely prosecute unpopular cases and the blame for unpopular cases falls on prosecutors, Congress is somewhat insulated from the costs of over-criminalizing. Consequently, Congress would prefer to err by over-criminalizing rather than by under-criminalizing or in spending resources to define the criminal law carefully.

**JUDGES** Might judges be able to slow down the criminalization juggernaut? After all, many judges are not elected, are less subject to public opinion, and are rarely blamed for a failed prosecution. On the other hand, the structure of the criminal justice system urges against this. First, judges do not often get to determine which cases they will adjudicate. If cases plea out, as most do, then those cases are rarely subjected to serious judicial scrutiny. Further, judicial doctrines such as vagueness, double jeopardy, and lenity are less effective when there are many precisely written criminal statutes.

Thus, there are many incentives that support corporate crime legislation or mute opposition to it. Corporate crime legislation satisfies public desires at a relatively low cost to corporate interests, and there are significant congressional and prosecutorial incentives to encourage this response to corporate malfeasance. If so, then what normative consequences arise?

### NORMATIVE CONCERNS

Let us assume that corporate crime legislation leads to liability deflection away from management. Is this normatively good or bad for society? Consider the following example.

Assume that to deter certain corporate wrongdoing appropriately we need to impose a penalty of \$5 million on the various corporate participants. Further, it does not matter how liability is partitioned between managers and the corporation if they can bargain cheaply amongst themselves as to how to distribute the liability. This is a simple application of the Coase Theorem — when bargaining is cheap (i.e., transactions costs are low), then the socially desired outcome should result.

But in reality, transaction costs are rarely zero and bargain-

ing between management and the corporation is rarely “arm’s length.” Thus, where liability is imposed does matter because that is where it is likely to rest. Consequently, we might prefer to place the lion’s share of liability on the corporation (i.e., the better risk-bearer) because society would like to reduce risk-bearing costs. Deflection facilitates this and thus might be desirable.

This account appears quite convincing for reducing risk-bearing costs of unintentional wrongdoing, but it is not clear that the same holds for the intentional or knowing behavior of management. The reason is a familiar one from the insurance literature. Insurance companies do not provide coverage for an insured’s knowing or intentional behavior because the insured would have an incentive to engage in the behavior — to collect the insurance payout (i.e., a moral hazard). Analogous moral hazard problems might arise if we shifted liability for management’s knowing wrongdoing away from management. That would, in effect, make the corporation an insurer for the knowing wrongdoing committed by management, thereby reducing management’s incentive not to engage in wrongdoing. Thus, if under-deterrence is a concern, then liability deflection for knowing wrongdoing worsens the situation.

Thus, the question is whether liability is being shifted away from management for unintentional wrongdoing or intentional/knowing wrongdoing. In the managerial criminal liability area, both kinds of wrongdoing exist, but as a general matter courts tend to require a showing of some *mens rea* before imposing criminal liability on individuals. Thus, it is plausible that there is liability deflection for intentional or knowing wrongdoing because of corporate criminal liability.

Of course, a counter-argument is that there is too much regulation and criminalization in the business sphere (i.e., over-deterrence), and liability shifting is desirable because it reduces risk-bearing for things that should not be “crimes” in the first place. My interest is not in debating whether over-deterrence is likely or not; my point is simply that the normative implications depend on one’s priors about the state of the world.

Let us then consider the other substitution thesis: Corporate crime legislation operates as a substitute for enhancements in corporate civil liability. If we believe over-deterrence is the problem, then corporate crime legislation is more desirable because, relative to increases in corporate civil liability, it is easier to constrain (given prosecutors’ incentives and resources and budgetary lobbying) and imposes lower social costs. Simply put, corporate crime legislation may satisfy public desires without aggravating the over-deterrence problem as much as corporate civil liability.

If, on the other hand, we believe there is under-deterrence, then an increase in corporate civil liability may be desirable because it leads to more enforcement than corporate crime legislation. That, however, is not the only effect. Because corporate crime legislation is more targeted, it is more likely to be used in meritorious cases than corporate civil liability and private litigation. Thus, corporate criminal liability is probably a more precise tool, whereas corporate civil liability is more frequent. Is the more precise or the more frequent tool better? There is no simple answer because the deterrent effect of the law depends on both the accuracy and frequency of its enforce-

ment. However, one might be inclined to think that increases in corporate civil liability are the better option in some areas because there are measures that could improve the quality of litigation (i.e., more meritorious suits), such as the PSLRA.

The normative implications can be quite complex. What is clear, however, is that those who start from the a priori view that corporate wrongdoing is under-deterred may want to argue for curtailing corporate criminal liability and increasing the focus on corporate civil liability and managerial liability. For example, if we think the deflection account is accurate and that under-deterrence is a concern, then we should want to reduce deflection (i.e., reduce corporate criminal liability). Similarly, those who believe that over-deterrence is the problem would favor increasing corporate criminal liability (when some congressional response is inevitable) to avoid more costly measures. The counter-intuitive nature of many of these conclusions raises intriguing questions about whether it makes sense to regulate the business arena in the way we have.

## CONCLUSION

One of the fundamental puzzles of corporate crime legislation is how does so much of it get enacted given that it targets cor-

porations that are considered some of the most powerful and effective (if not the most powerful and effective) lobbyists in the country. My analysis suggests that corporate crime legislation may grow because it is a preferred response for corporate interests when some congressional action is inevitable. Corporate criminal liability's growth could then be explained by the following: Some degree of "punishment" is necessary, as a political matter, to satisfy public desires during recessions when revelations of corporate wrongdoing are numerous, and corporate crime legislation achieves that while imposing lower costs on business interests relative to other measures that could be undertaken (e.g., increasing corporate civil liability or managerial criminal sanctions).

The normative implications depend on one's priors about the world and on which political account(s) one finds persuasive. However, one thing appears clear regardless of the preferred political account(s): If we start with the notion that corporate wrongdoing is under-deterred, then we would want to argue for curtailing corporate criminal liability and increasing the focus on corporate civil liability and managerial liability. That raises serious questions about how we regulate this area. **R**

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