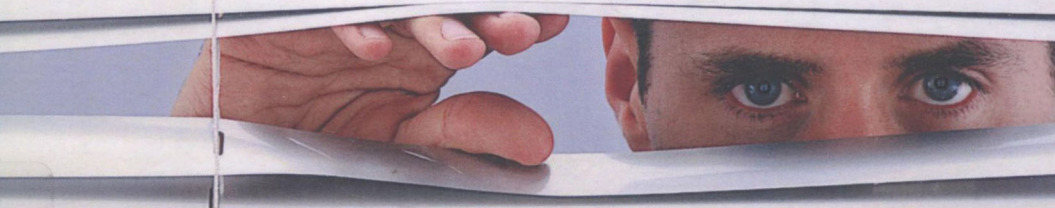
CORPORATE BODIES AND GUILTY MINDS

The Failure of Corporate Criminal Liability

WILLIAM S. LAUFER



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Corporate Bodies and Guilty Minds

For Edith and Jack Laufer

Preface

Given the daily revelations of corporate misdeeds, one might expect *Corporate Bodies and Guilty Minds* to chronicle the inner workings of Adelphia, Arthur Andersen, Bristol-Myers Squibb, Computer Associates, Dynegy, Enron, Global Crossing, HealthSouth, Marsh & McLennan, MicroStrategy, Parmalat, PeopleSoft, PNC Financial Services, Qwest, Rite Aid, Tyco, Waste Management, WorldCom, Xerox and the malfeasance of those who joined the rogues' gallery of white-collar criminals. This book could have chronicled the activities of the fine accounting firms that audited these leading companies, including Arthur Andersen, Deloitte & Touche, Ernst & Young, KPMG, and PricewaterhouseCoopers. There now exists, however, a considerable library of exposés of the victims, gatekeepers, and victimizers involved in the recent wave of corporate scandals.

Instead, *Corporate Bodies and Guilty Minds* raises questions about the failure of corporate criminal law. This book is as much about Enron as it is about Lockheed, as much about Lockheed as it is about Standard Oil, and as much about Standard Oil as it is about New York Central and Hudson River Railroad. Corporate deviance is a historical fixture, and waves of scandals are as familiar as are periods of reform. Unfortunately, there is scant evidence that reforms necessarily bring about lasting change in corporate behavior in spite of convincing rhetoric to the contrary. This book offers some reasons why that is so, while arguing strongly for greater reliance on principles of criminal liability that recognize the complexity of organizational behavior, the difficulty of obtaining evidence of corporate wrongdoing, the privileges and responsibilities that come with ascribing personhood to corporations, and the law's ambivalence over ascribing blame to corporate entities. Arguments are made mindful of the dearth of systematic empirical research on corporate crime and punishment, research that is critically needed to fashion coherent policy, draft effective legislation, and leave lasting reform.

Corporate Bodies and Guilty Minds offers a critical account of corporations seeking to bolster perceptions of responsibility, law abidance, and citizenship by institutionalizing a brand of compliance-driven ethics. Those executives and employees who dare violate codes, regulations, or laws do so at their own peril. Corporate miscreants are nothing more than wayward agents who, in spite of compliance initiatives, walk up to and over the line—or so the script goes. In distancing the entity as a decision-making body from its agents, corporations through the actions of top management try to support the self-serving perception that the criminal law is a less-than-optimal form of social control or, better yet, that it serves a very limited regulatory purpose.

Extant law and supportive doctrine are often nothing more than an opportunity for clever corporate counsel to exploit as part of a larger, corporate-wide management of reputation. In recent years, corporate criminal law has become a blueprint of preventive law for organizational entities. Avoiding the strictures of corporate criminal law is too often a matter of gaming both prosecutors and regulators with a mix of cooperation, disclosures, and audits. Skills and strategies for this game are available for sale at a host of high-priced "ethics" conferences, from a new breed of reputation and integrity management firms, from tried-and-true consulting firms, and from a legion of prosecutors-turned-defense-counsel who, better than most, know when to bluff, raise the ante, or fold. Gaming is implicitly encouraged by prosecutors who, in their vast discretion, make offers and deals aimed at producing inculpatory evidence that is otherwise shrouded by the corporate form. Where compliance failures undermine their standing, corporate public relations offers a cure with glossy and elegant annual reports detailing social and environmental accomplishments. Corporations that want to be seen as ethical "stewards," but have much to hide, wash their reputations—"greenwash" environmental violations or "bluewash" by suggesting ethical leadership and affiliating with the United Nations or other strategic nongovernmental organizations or standards groups.

We should see beyond the often cosmetic veil of organizational compliance, corporate gamesmanship, and washed reputations by construing corporate fault in a way that allows for reasonable attributions of liability and culpability. Here I propose a constructive corporate liability, a liability rule that frees those who regulate and prosecute corporations of proving fault vicariously. Instead of a strict attribution of fault, the nexus between an individual agent's and a firm's fault is at issue. Reasonable attributions of blame replace vicarious liability. Constructive fault therefore invites prosecutions that, due to concerns over the harshness of vicarious fault or reasons of corporate gaming, are now unlikely or failed. Perhaps the logic and appeal of a constructive corporate fault will engender a constituency advocating the

use of substantive corporate criminal law that will, ultimately, affect the law enforcement priority accorded corporate prosecutions.

Promoting such a constituency assumes that we should give greater priority to the enforcement of criminal laws against corporations when and where deserved. It assumes a value in proceeding against the corporation as an entity, in addition to any individual officers, directors, or agents who might be deserving of blame—no matter how senior or subordinate. It assumes that the criminal law can play an important role in making standards of corporate governance and governance reforms more than incidental, nonbinding conduct codes. It assumes that failures of corporate governance—failures of boards and their committees, for example, to monitor compliance and code enforcement on behalf of the shareholders—are seen also as failures of compliance. It assumes that the name of the game from the enforcement side is access to inculpatory evidence through cooperating witnesses and increased protections afforded to whistle-blowers. It also assumes the importance of a credible and predictable criminal law that considers the criminal offense over the corporation's postoffense behavior. And, finally, in considering the importance of a constituency supporting a substantive corporate criminal law, the historically powerful role of politics in fashioning corporate reforms must never be forgotten. Too little attention is given to the instrumental role of corporate lobbyists, corporate donations, and willing legislators.

These are far from extraordinary themes. Yet, remarkably, there is no constituency with a voice that genuinely and consistently favors resort to the corporate criminal law. Businesses seek to avoid it, fearful of reputational effects and the potential for liability in some industries to limit lines of business, as in the health-care field. Regulators and prosecutors generally shy away from prosecuting corporations for reasons having as much to do with resources as the perception that the real offenders—officers, managers, and subordinate employees—must be prosecuted for justice to be served. It would be a mockery of justice, most would say, to take principles of vicarious liability so seriously that Fortune 500 corporations are ultimately executed due to the acts of disloyal, miscreant agents. A significant value of the corporate criminal law, prosecutors admit, is its ability to close a deal. Threat of criminal indictment results in favorable civil settlements and workable plea agreements.

Legislatures lack the political will in the face of heavy corporate lobbying to meaningfully reform the substantive corporate criminal law. The failure of the Brown Commission is an obvious illustration. Less obvious, though equally on point, is the commanding and largely undeserved role enjoyed by the United States Sentencing Commission. So much law reform has come from this commission in recent years that it makes federal criminal law reform, including the tinkering of Sarbanes-Oxley, look feeble and the

federal corporate criminal law appear wholly inadequate. Even worse but certainly not surprising, the effect of the commission's guidelines successfully moved the locus of discretion, and resulting concerns with disparity, from the chambers of federal judges to the many offices of the United States attorneys, where prosecutorial guidelines give no more than the pretense of uniformity. It is unclear where discretion will ultimately rest after the Supreme Court's decision to recast the mandatory nature of the guidelines.

In the absence of a constituency that advocates reliance on corporate criminal law, prosecutions are rare events in the criminal justice system. There are many reasons to shy away from proceeding directly against guilty corporations, and, unfortunately, they are all too often relied on. Without apology, I do not seek optimal enforcement or penalties or, for that matter, standards of culpability that maximize the deterrence function of the criminal law. I take the necessity and survival of the corporate criminal law for granted, simply as a matter of justice.

Of course, not all agree. Economists challenge the premise of anything more or less than an optimal enforcement and punishment regime. To their chagrin, the criminal law can and often does lack efficiency. Philosophers and legal scholars continue their diatribe on corporate personhood, the value of *integrity-based* corporate compliance, and different strategies or styles of self-regulation. Employees and shareholders are only further victimized by corporate crimes. And, finally, as prodemocracy advocates fight against thinly veiled neoliberal ideologies and the perceived evils of global corporate domination, they reject the notion of a corporate person, the requisite for corporate criminal liability.

The fire behind my account is the same that moved Justice Jackson in the seminal case of *New York Central & Hudson River Railroad v. United States*—with the benefit of an additional century of reflection on the artful and cunning nature of corporate stratagems. This decision by the United States Supreme Court, more than any before it, laid out a clear case that public policy requires extending the criminal law to corporations. At the turn of the twentieth century, corporate criminal liability foreshadowed the rise of the regulatory state as an indispensable weapon in the seemingly weak arsenal of social controls over the dramatic expansion and concentration of corporate power, an expansion and concentration marked by an increasing separation of ownership from control. Of course, those were different times. But with the rise of the regulatory state and the move away from command and control regulatory styles, the corporate criminal law was neglected if not all but forgotten. We are left with century-old liability rules that are resurrected for reasons of prosecutorial convenience or symbolic need. The only substantive reform came in piecemeal fashion or through the back door of sentencing and prosecutorial guidelines.

The rapid globalization of the corporate form and the dramatic rise of corporate power renew the call for principles of corporate criminal law that give strength, legitimacy, and integrity to regulatory and administrative law. Without a strong criminal law overseeing the regulation of corporate entities, there is far too little at stake in the game. Without a strong criminal law, regulation is perceived to be entirely voluntary, it is gamed, and regulators lose credibility. And, perhaps most important, without principles of liability that accommodate the law's ambivalence with ascribing blame to corporations, all will seek to avoid corporate liability in favor of other less-formal social controls.

It may be said with some confidence that little has changed over the past hundred years in the evolution of the corporate criminal law. Sadly, the legal questions raised by recent corporate scandals are remarkably similar to those in the early 1900s. These cases are all too familiar, and there is scant empirical evidence that corporate deviance has been affected—or is now affected—by recent reform efforts. What is needed is a sea change in how the criminal law is applied to corporations. Such a change requires the abandonment of vicarious liability in favor of a model of corporate liability that leverages objective judgments of fault that mix personal ascriptions of blame with the very characteristics, attributes, and actions of the entity that gives rise to liability. Reform to the substantive criminal law must follow so that it comports with the changes brought about by the Sentencing Guidelines for Organizations. Such reform entails a reconceptualization of corporate governance in relation to corporate compliance. It also requires according priority to corporate crime cases in federal law enforcement. Without these and other changes, without a constituency advocating the use of corporate criminal liability, a pessimist's and skeptic's account of corporate crime and corporate liability prevails.

The first three chapters set the stage for a critical look at the law's ambivalence with the corporate criminal law. Chapter 1 surveys the modest evolution of the corporate criminal law. Its history reflects many significant milestones, many notable cases, and many notorious companies. It also reveals scant progress toward a coherent body of legal principles. The reason offered for this modest progress is a central theme throughout this book—an ambivalence with applying the criminal law to corporations. Chapter 2 suggests one important reason why progress has been slow. Over the past century, the corporate criminal law has failed to resolve the seemingly intractable problem of personhood and, at the same time, to articulate a theory of liability that considers the organizational form—aspects of the corporate person—in relation to blame. Prosecutorial and sentencing guidelines count the actions and inactions of entities that the substantive law disregards. Chapter 3 proposes a constructive corporate liability doctrine

as a preferred solution for at least some aspects of this intractable problem. Unlike principles of vicarious liability, constructive liability casts blame in relation to aspects and attributes of the organization. Reasonable attributions of fault facilitate the finding of organizational liability. Constructive corporate liability allows the substantive law to meaningfully join sentencing law, taking the law's ambivalence into consideration and accommodating the stratagems of firms.

The balance of *Corporate Bodies and Guilty Minds* details the risks of maintaining the law's status quo. Chapter 4 describes strategies employed by some corporations to avoid the strictures of criminal liability. Such strategies include gaming regulators who, in spite of much rhetoric to the contrary, are constrained by principles of vicarious liability and lack the necessary tools to evaluate the effectiveness of a company's compliance efforts, no less its governance practices. The rise of internal and external audits as evidence of compliance is noted and discussed. Chapter 5 considers the critical importance of corporate cooperation in defeating the attribution or imputation of blame to the entity; the desirability of trading prosecutorial favors for corporate cooperation is explored. Chapter 6 reviews the disconnect between corporate representations of integrity and ethicality. For some companies, business ethics is reputation management, where the ethical leaders, those leading the ethical charge, are often the worst corporate offenders. The problem of greenwashing is discussed in relation to the case of *Nike v. Kasky*, the first legal challenge of reputation washing as consumer fraud. Finally, Chapter 7 briefly details why the skeptic's and pessimist's account of recent reforms is, unfortunately, most plausible.

Books that wrestle with corporate crime face a number of predictable challenges. The problem of corporate deviance resists simple description, simplistic generalizations, and simpleminded theory. Crimes in the healthcare, financial services, and manufacturing sectors, for example, share important similarities and critical differences. The range of misbehaviors associated with corporate crime also varies widely, as does the status or statuses of offenders. And finally, the law does little to overcome or undo unrealistic and unfair stereotypes of corporations as large, decentralized, publicly traded entities. Knowing that these and other difficult challenges remain makes the study of corporate crime both fascinating and humbling.

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Research for *Corporate Bodies and Guilty Minds* developed through the preparation of a series of law review and journal articles on the corporate criminal law. In various places throughout this book, I draw generously from this work. My appreciation to the editors and reviewers of Social Accounting and the Corporate Greenwashing, 43 J. Bus. Ethics 253–61 (2003); Corporate Prosecution, Cooperation, and the Trading of Favors, 87 Iowa L. Rev. 123–50 (2002); Corporate Liability, Risk Shifting, and the Paradox of Compliance, 54 Vand. L. Rev. 1343 (1999); Due Diligence, Corporate Integrity, and the Limits of the Good Citizen Corporation, 34 Amer. Bus. L.J. 157–81 (1996); Corporate Bodies and Guilty Minds, 79 Emory L.J. 649–732 (1994).

Gerhard O. W. Mueller inspired my interest in the corporate criminal law during law school and while I attended graduate school. For this inspiration, and for his continued wise counsel, I am most grateful.

Contents

PART ONE

The Law's Ambivalence

CHAPTER ONE

The Evolution of Corporate Criminal Law

During the past year the American economy has faced several sudden challenges, and proven its great resiliency. Terrorists attacked the center and symbol of our prosperity. A recession cost many American workers their jobs. And now corporate corruption has struck at investor confidence, offending the conscience of our nation. Yet, in the aftermath of September the 11th, we refuse to allow fear to undermine our economy. And we will not allow fraud to undermine it either.

With well-timed tax cuts we fought our way out of recession and back to economic growth. And now with a tough new law we will act against those who have shaken confidence in our markets, using the full authority of government to expose corruption, punish wrongdoers and defend the rights and interests of American workers and investors.

My administration pressed for greater corporate integrity. A united Congress has written it into law. And today I sign the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt. This new law sends very clear messages that all concerned must heed. This law says to every dishonest corporate leader: you will be exposed and punished; the era of low standards and false profits is over; no boardroom in America is above or beyond the law.

This law says to honest corporate leaders: your integrity will be recognized and rewarded, because the shadow of suspicion will be lifted from good companies that respect the rules.

This law says to corporate accountants: the high standards of your profession will be enforced without exception; the auditors will be audited; the accountants will be held to account.

This law says to shareholders that the financial information you receive from a company will be true and reliable, for those who deliberately sign their names to deception will be punished.

This law says to workers: we will not tolerate reckless practices that artificially

drive up stock prices and eventually destroy the companies, and the pensions, and your jobs.

And this law says to every American: there will not be a different ethical standard for corporate America than the standard that applies to everyone else. The honesty you expect in your small business or in your workplaces, in your community or in your home, will be expected and enforced in every corporate suite in this country.

I commend the Congress for passing a strong set of reforms.[1]

*

With these comments, President George W. Bush signed Sarbanes-Oxley 2002 into law on July 30, 2002. This "groundbreaking" legislation and a host of regulatory reforms came on the heels of countless revelations of corporate fraud, multiple waves of accounting scandals, innumerable restatements of corporate earnings, evidence of "naked greed," and a very shaken market.[2] The result was predictable: Regulators and legislators carefully examined the gatekeeping and oversight role of all corporate stakeholders, including auditors, boards of directors, investment banks, credit rating agencies, and lawyers. Questions were raised about the effectiveness of existing laws, regulations, and regulatory bodies.[3] Reform bills were introduced in Congress. The New York Stock Exchange and Nasdaq announced governance reforms. So, too, did the Securities and Exchange Commission. Criminal investigations and prosecutions of corporate miscreants followed. The costs and burdens of regulating compliance for firms dramatically increased. And the conventional wisdom quickly emerged that what matters most is that investors are protected and our confidence in the integrity of corporations restored.[4]

These legislative and regulatory responses are more comforting and reassuring than meaningful. Reforms are proposed and unveiled by government functionaries with an uncomfortable share of righteousness and moral outrage. Prosecutions are orchestrated media events designed to convey a strong symbolic meaning about investor confidence, the strength of regulatory oversight, and the potency of corporate sanctions. The federal government declared war on corporate fraud. All of this encourages the unsuspecting to believe that solutions to corporate deviance for some of the most powerful multinational corporations may be found in narrowly drawn governance and accounting standards, that combating elite deviance through criminal prosecutions will remain a high priority of federal and state law enforcement, that politics has little to do with law enforcement or regulatory priorities, and that this is the first generation to watch our most powerful firms and financial icons fall precipitously from grace.[5]