PUNISHING CORPORATE CRIME

Legal Penalties for Criminal and Regulatory Violations

JAMES T. O'REILLY

JAMES PATRICK HANLON

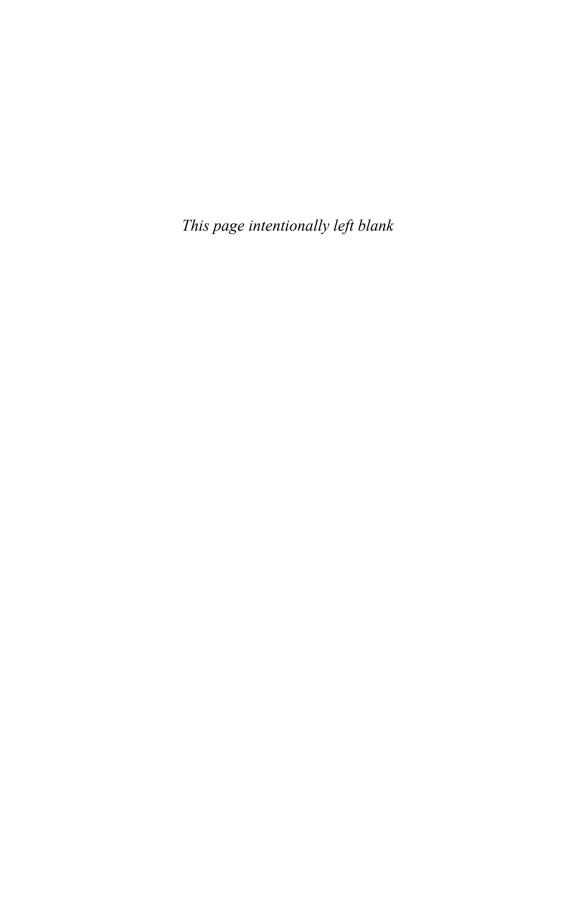
RALPH F. HALL

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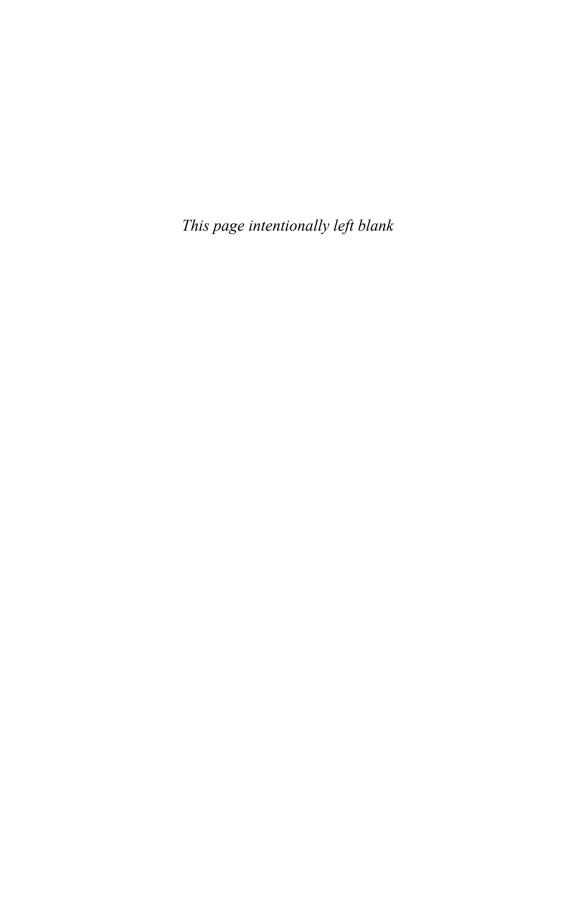
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This book is dedicated with thanks to
Daniel Carmichael, Esq.
for his kindness, sage wisdom, and leadership
shared over many years
with students, young lawyers, and colleagues
who have valued his friendship



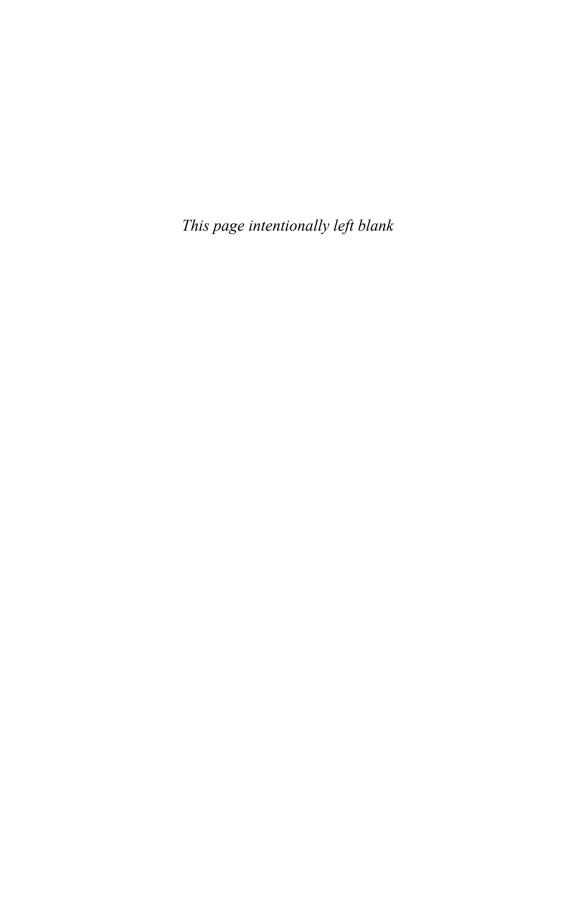
Foreword

The "rule of law" has been much discussed in recent years as a paragon virtue in our democratic society. This book is about one aspect of that rule of law, the principle that organizations are not "above the law," and that punishment for serious misconduct is an appropriate societal response when organizations commit offenses. The great majority of corporations already comply with the legal requirements and perform their vital function for our free market economy without violating the law.

The challenge we discuss in this book is *how* to provide a rational system of punishing wrongdoers, so as to encourage more appropriate behaviors within the systems of civil, regulatory, and other structures of compliance. The creative efforts of prosecutors, defense counsel, legislators, and regulators have all contributed to the current system for sentencing, diverting, or providing alternative remedies against the violators of laws. We hope that you will utilize the lessons learned by our authors and expressed in these pages in counseling your clients so as to diminish the need for punishments in the future.

The authors will appreciate suggestions and requests for improvements in future editions; all can be reached via Baker and Daniels, at http://www.bakerdaniels.com.

Professor James T. O'Reilly



Contents

Preface		
1.	Introduction	
2.	Defining the Problem	
PART II	LIABILITIES AND RIGHTS OF THE CORPORATION AND MANAGERS	
3.	Principles of Criminal Liability for Corporate Misconduct	
4.	Constitutional Considerations	
5.	Individual Criminal Liability Related to the Corporation 41 James Patrick Hanlon	
6.	Criminal Statutory Liability and Interpretation	
PART III	UNDERSTANDING THE PROCESS	
7.	The Federal Criminal Investigation Process	
8.	The Process of Defining Charges Against the Individual	
9.	Training for Avoidance of Potential Future Criminal Liabilities 91 <i>Erin Reilly Lewis</i>	

PART IV CRIMINAL PENALTIES AND RELATED REMEDIES

10.	Corporate Integrity Agreements	
11.	Deferred Prosecution and Non-Prosecution Agreements	
12.	Understanding and Complying with Compliance Agreements 155 Ralph F. Hall	
13.	Remedies of Disgorgement and Restitution	
14.	Related Civil Remedies: Administrative Penalties and Injunctions 209 <i>Prof. James T. O'Reilly</i>	
15.	Qui Tam Relator Suits and False Claims Act Proceedings	
16.	Post-Conviction Debarment of Corporations	
Table of Cases		
Index		

CONTENTS

Preface

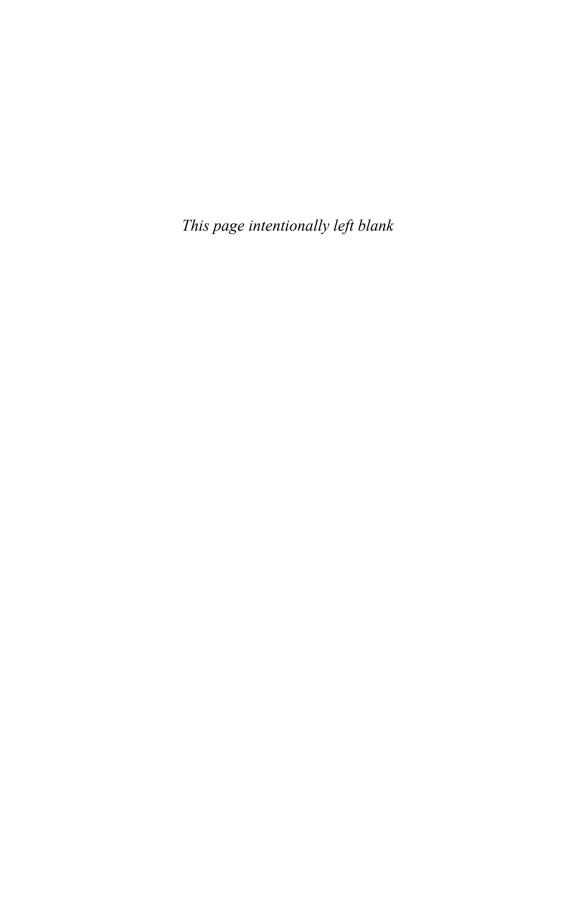
The reader is already aware of the classic dramatic theme asserted in entertainment programming that "crime does not pay." Ultimately, crime does not benefit the purposes of the corporation: maximization of shareholder benefit, and delivery of goods and services that benefit society at large. Crime distracts the organization from its more laudable pursuits and diverts its efforts with the costs and delays of defending the challenged behavior. In the short term, individuals might profit and some may escape detection or prosecution, but ultimately the adage is correct: criminal violations have net negative consequences for the organization's future success.

Innovative penalties for law violations include criminal fines, debarment from licensure or product approval, civil money penalties, proscription of new product clearance, and other tools described in this text. The purpose for writing this text is to describe these penalty alternatives and to evaluate how they can best be managed both in defense and in avoidance of problems. Counsel representing the companies should consider the potential benefits of each of the possible alternatives when defending a client, since government agencies and prosecutors may be less familiar with all these options. This book equips the reader with a wider set of options than the prosecutors may be aware of—and so it allows the responsible management team to suggest a way of resolving the enforcement issues that is still compatible with the needs of the prosecutor or regulatory agency.

The best use of this book is for educating clients on what *not* to do, because the consequences of misconduct can be so severely disturbing to the company's growth or progress, or even its survival. Think twice before the false report or the suppression of "bad news"; the potential fallout from the criminal act is described in painful detail in this book.

Finally, consistent with standard norms for legal publications, the advice given in this textbook is not provided as legal advice for any person's particular situation. For specific cases, competent and experienced legal counsel should be retained.

Professor James T. O'Reilly March 2009



About the Authors

Baker & Daniels has more than 370 lawyers and legal professionals in seven offices. From Indianapolis, Fort Wayne, South Bend, Chicago, Washington, D.C., and Beijing, its lawyers serve clients in regional, national, and international transactions, regulatory matters, and litigation. The firm, founded in 1863, has provided counsel to major national and international clients on issues relating to compliance and to the successful resolution of civil and criminal proceedings.

Lead Author and Editor **James T. O'Reilly** has been a successful legal author since 1977, when his first treatise on privacy and information law became a widely used reference, and the U.S. Supreme Court quoted his FDA text in 2000 with the words, "The experts have written. . . ." He is a former state police officer in New York and has taught criminal law, among other courses, at the University of Cincinnati. His articles have appeared in law journals at Yale, Columbia, Harvard, Cornell, and other schools, for a total of 164 published articles, and his 38 texts have been widely cited by federal and state courts. He formerly served at Procter & Gamble as Associate General Counsel. In addition to his teaching, Professor O'Reilly is Counsel to Baker & Daniels of Indianapolis and Vice-Mayor of a small Ohio city. In 2008, he completed work as Assistant Chief Reporter of the Project on European Union Administrative Law, funded by the EU and the American Bar Association. He was Section Chair of the 16,000-member Section of Administrative Law & Regulatory Practice of the American Bar Association in 1996–97. He is a graduate of Boston College and the University of Virginia School of Law, where he is a member of the Dean's Council.

James Patrick Hanlon concentrates his practice in the area of white collar criminal defense. He has prosecuted and defended a wide variety of criminal matters as an assistant United States Attorney and as a defense lawyer. Since joining Baker & Daniels as a partner in August 2006, Mr. Hanlon has represented individuals in federal criminal financial and securities fraud investigations, individuals in SEC investigations and enforcement actions, health care providers in federal investigations involving allegations of criminal and civil Medicare and Medicaid fraud, individuals in investigations and prosecutions involving allegations of fraud and conducted internal investigations. He also authored the chapter, "Meeting with a New Client: The Initial Stages of Defense," published in White Collar Law Defense Strategies: Leading Lawyers on Preparing for Trial, Offering Evidence and Overcoming the Challenges of a White Collar

Crime Case (Aspatore Publishing, June 2007), and has given numerous presentations on topics related to white-collar crime and internal investigations.

Mr. Hanlon is a member of the ABA's Criminal Justice Section, White Collar Crime Committee, and regularly attends its annual White Collar Crime Institute. As a member of the National Association of Criminal Defense Lawyers, he attends its annual Defending the White Collar Case Seminar. Before joining Baker & Daniels, Mr. Hanlon served almost five years as an Assistant United States Attorney with the U.S. Attorney's Office in Indianapolis. As a federal prosecutor, he investigated and prosecuted violations of a variety of federal criminal laws, including fraud, embezzlement, tax crimes, criminal monetary transactions, firearms possession and trafficking, and violent crime. As an Assistant U.S. Attorney, Mr. Hanlon tried 15 cases to verdict in U.S. District Court and argued multiple cases before the U.S. Court of Appeals for the Seventh Circuit. Mr. Hanlon began his career serving as a law clerk to the Honorable Robert L. Miller, Jr., U.S. District Judge, Northern District of Indiana, South Bend Division.

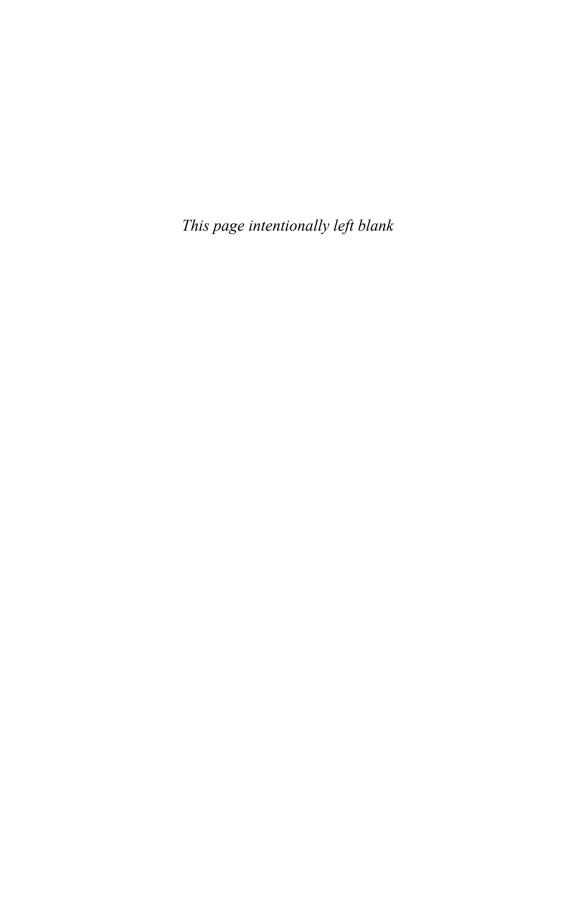
Erin Reilly Lewis joined Baker & Daniels after serving as an Assistant U.S. Attorney for the U.S. Department of Justice in the U.S. Attorney's Office for the Southern District of Indiana. In that role, she was the district's civil health care fraud coordinator where she investigated and prosecuted violations of civil fraud involving the False Claims Act, Anti-Kickback Statute, Stark Act, HIPAA, Controlled Substances Act, and others. Erin argued numerous cases on behalf of the Attorney General in front of the 7th Circuit Court of Appeals. At Baker & Daniels, Erin is a member of the firm's health and life sciences practice, focusing on compliance and investigation matters. She counsels clients on compliance issues and represents health care providers in criminal fraud and abuse investigations and civil False Claims Act lawsuits, among other matters. She has counseled major medical device manufacturers on compliance related issues and advised on their internal policies and procedures. She also has helped clients navigate through regulatory and compliance issues related to clinical trials. She is also teaches Legal Writing at Indiana University School of Law–Indianapolis.

Ralph F. Hall joined Baker & Daniels in 2004 after serving as Deputy General Counsel at Guidant Corporation. In his career at Guidant and Eli Lilly, Ralph was involved in the development of compliance programs, drafting codes of conduct and in handling various government inspections and investigations on both the civil and criminal fronts. Ralph was involved in enforcement matters including a consent decree, criminal plea and a Corporate Integrity Agreement. He led a number of internal investigations and self disclosures to government regulators. At Baker & Daniels, he counsels clients on FDA matters and on the creation, implementation and assessment of compliance programs. He also serves on the faculty at the University of Minnesota Law School as Distinguished Visiting Practitioner and Professor. He teaches FDA courses and negotiation courses. He has also developed and taught the first corporate compliance seminar at the law school. This seminar explores the legal requirements for compliance programs and the implementation and assessment of compliance programs. This seminar also includes an analysis of legal issues surrounding compliance assessments and organizational structure and operational issues involving compliance program. Ralph has authored a number of articles on FDA and compliance matters.

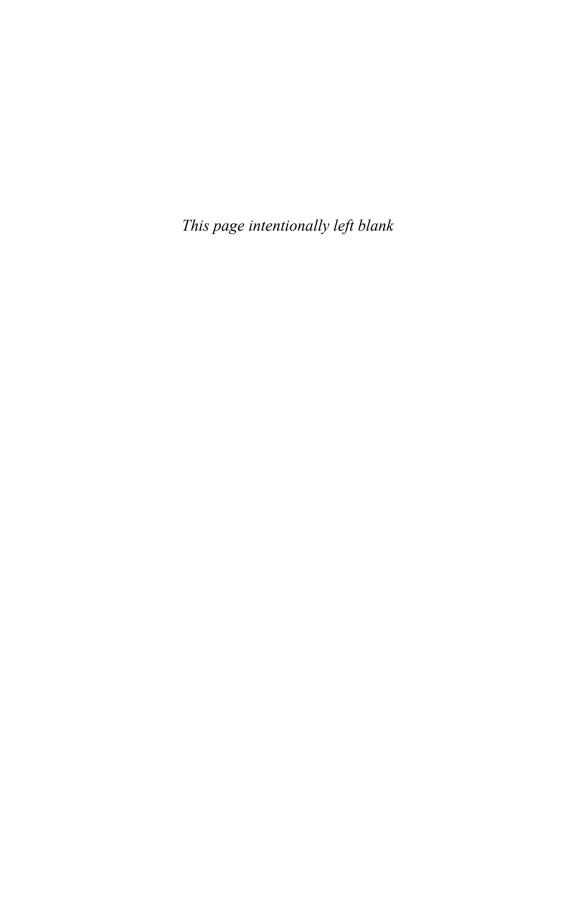
xiv ABOUT THE AUTHORS

Steven L. Jackson is a partner in Baker & Daniels, Ft. Wayne, Indiana. Mr. Jackson concentrates his practice in the representation of major health care providers, including False Claims Act litigation, Fraud and Abuse counseling, peer review proceedings, institutional review boards and ethics committees. He has been successful defense counsel in False Claims Act ("qui tam") proceedings and advises clients in those defense issues. He led the defense in a federal *qui tam* claim against a major hospital system. The case resulted in no payment to the Relator or the government, and complete dismissal of the claim. He also serves as principal trial counsel in employment discrimination and civil litigation matters in state and federal courts across the nation.

ABOUT THE AUTHORS xv



PART I Introduction



Chapter 1

Introduction

Prof. James T. O'Reilly

- 1:1 Overview 3
- 1:2 How This Book Is Organized 4

1:1 OVERVIEW

This book is different. Law libraries have shelves full of books on defining crimes, detecting crimes, and conducting criminal jury trials. This book takes a different perspective.

This book assumes that misconduct has occurred, and that society wishes to exact some penalty from the malefactors. But society cannot imprison a legal fiction, a corporation, and so the punishment that society can obtain will take other forms that are studied in this book. Corporations cannot be shackled by irons, or shot by firing squad, but they can be subjected to monitoring and debarment and several forms of starvation including fines, disgorgement, receivership, etc.

Corporations are an undeniably powerful force in our modern economy, and sometimes the activities of corporations violate statutes that carry criminal enforcement sanctions. When the corporation commits a criminal offense, the punishments have generally been limited to fines since other traditional criminal sanctions (e.g., incarceration) have no meaning as applied to a corporate entity. Practically speaking, a fine could be secured through a civil penalty action (and at a lower standard of proof), so the question still remains as to what alternatives are available when a corporate criminal act deserves punishment.

At the outset, the problem of corporate crime has not been well developed in those traditional sources of law-book content, the published opinions of appellate courts. A focus on appellate opinions alone does not satisfy the reader's need for understanding this evolving field. Judges take the legislative scheme of punishment for granted, and some punishments are settlements that judges spend little time on before accepting

the bargains. Even those law student guidebooks on "white collar crime" admit that society does not have a uniformly clear understanding of what remedies work and what are excessive. The problem remains: how to punish the misdeeds of corporations. This text recognizes that our means of enforcement and punishment remain in debate.

Deterring abusive conduct by the corporate entity has traditionally come in two forms. A fine is assessed against the corporation for a violation. Through doctrines of vicarious liability, an employee or executive is individually prosecuted and if, convicted, imprisoned, fined, or both. Sometimes the corporation pleads guilty and pays a fine so that its executives are spared from facing a trial.

A transition away from simple imposition of corporate fines is rapidly evolving. Relatively recent corporate prosecutions have sought even stiffer penalties, driving the corporation out of business. For example, as a result of actions related to the Enron scandal, accounting firm Arthur Andersen was stripped of its professional license, essentially dealing a "death penalty" to the company. This sanction might be considered draconian, punishing the innocent employees and investors. The Andersen firm employed 28,000 before its collapse, but probably 99 percent of these workers were not involved with the misconduct. This book will explore creative alternatives that do not involve the "death penalty" or a mere "business as usual" penalty.

Government prosecutors and defense attorneys increasingly seek innovative ways to deal with corporate misconduct. Prosecutors, faced with regulatory and economic criminal violations (for example, releasing pollution, marketing knowingly dangerous products, fraudulently overbilling Medicare, shipping technological goods to another nation without a license, selling unapproved drugs) have evolved away from "jail or fines" options to a new set of more severe and intrusive punishments. Both the modern statutes and the recent decisions of innovative prosecutors under older statutes have tended in the direction of enhancing punishments by creative alternative penalties, such as:

- deferred prosecution agreements
- · corporate integrity agreements
- · receivership and monitoring
- · disgorgement of profits

The phenomenon of anticipating, avoiding, and dealing with these "new punishments" is novel for corporate managers and their counsel. Prudent managements want to prevent criminal liability through efficient ethics and internal control programs. Creating an ethical corporate environment requires a well-considered education and oversight program. This text will set a foundation for the preventative and anticipatory efforts of the prudent corporation and its counsel.

1:2 HOW THIS BOOK IS ORGANIZED

Part I sets the foundation for addressing the problem and the alternate solutions. Part II will define the policy concerns, examine constitutional and statutory aspects of the

problem, and offer background information about how corporations can avoid the punishments discussed in the later parts.

Part III explains the process steps that the prosecution and defense counsel will follow in handling the criminal case. Written by former prosecutors with ample support from the federal manuals, these chapters are insightful explanations of the stages of decision, indictment, trial, and post-trial activities.

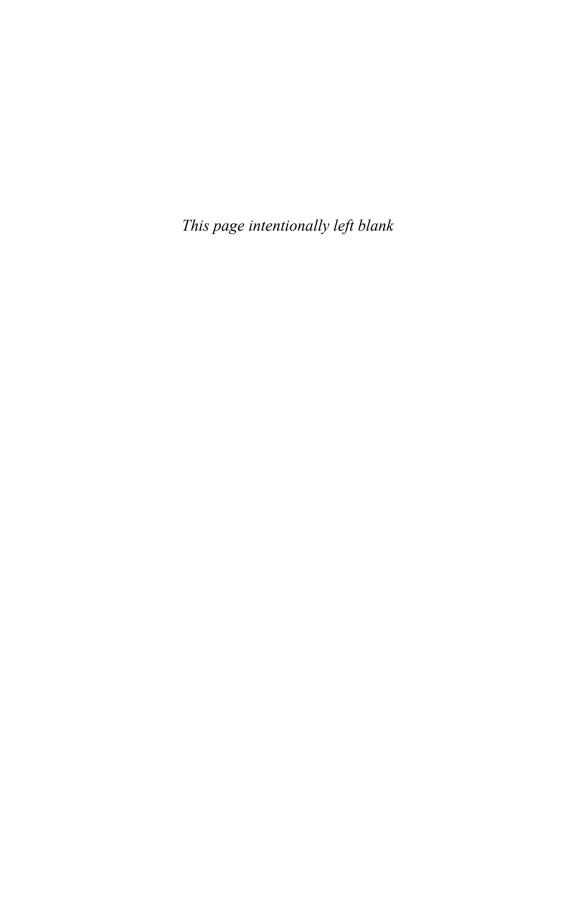
Part IV addresses the core issue for the reader—what will the criminal prosecution options be for the prosecutors of the future, evolving from the powers held by today's prosecutors. Each of these themes is uniquely challenging for the reader, as so few reported appellate cases have fixed precedents in this field, and so much of this will be predictive and based on experiences of the authors and their professional colleagues. This part will be "required reading" for corporate counsel, since the policy issues and the alternative punishments discussed here are the core of the book's value to its readers.

Part IV also focuses on the new agreements, such as corporate integrity agreements and deferred prosecution agreements, which have drawn extensive news media attention in very recent times.

Chapter 13 addresses noncriminal alternatives. Defenders of the corporation are very likely to try to steer prosecutors away from the stigma of criminal penalties and toward the utilization of one of these civil, noncriminal, alternatives. Notable in this chapter is the wide discretion the judge will have in fashioning remedies and using contempt powers to compel adherence to terms of the civil alternative. Special statutory powers will be necessary for imposition of civil administrative penalties; these bear some consideration in this book as alternative options. These options are favored when the regulatory agency sees its burden of proof lessened and its delays reduced, by using its own civil penalty mechanism in lieu of criminal court proof beyond a reasonable doubt, especially for a violation of a complex regulatory requirement.

In summary, we offer the reader a perspective on the "new punishments" and how one should respond to and deal with their challenges to and impact upon the modern corporation.

INTRODUCTION 5



Chapter 2

Defining the Problem

Prof. James T. O'Reilly

- 2:1 What Is the Problem of Corporate Misconduct and Its Punishment? 7
- 2:2 What Manifests the Existence of the Problem? 8
- 2:3 How Significant Is the Problem of Criminal Misconduct by Corporations? 8
- 2:4 How Has the Law Dealt with Corporate Crime? 9
- 2:5 What Are the Constitutional Constraints Surrounding This Problem? 10
- 2:6 What Are the Elements of the Statutes Creating Criminal Offenses? 10
- 2:7 What Has Been the History of Criminal Punishment of Enterprises in America? 12
- 2:8 How Has the Rise of Deterrent and Preventive Criminal Sanctions Impacted Corporations? 13
- 2:9 How Do the Federal Sentencing Guidelines Apply After the 2007 Supreme Court Decisions? 14
- 2:10 Does the Deterrent Model of Punishment Succeed in Altering Corporate Behavior? 14
- 2:11 How Does This Text Relate to White Collar Crime? 15
- 2:12 How Did the Use of Strict Criminal Liability in Criminal Cases Arise? 15
- 2:13 Can Both the Individual Officer and the Corporation Be Punished? 17

2:1 WHAT IS THE PROBLEM OF CORPORATE MISCONDUCT AND ITS PUNISHMENT?

We define the problem of *corporate misconduct* as actions by an organizational entity that violate one or more statutes. The problem is a function of the collision between legislated prohibitions on certain corporate decisions and the aggressive business operations that come near or cross that line of prohibitions. The social policy judgment that a particular act or series of acts is "misconduct" will vary with norms of the community, the accepted "culture" of business sectors, the ethical standards of players in that competitive market, and related factors. The decision to impose punishment for misconduct is the policy decision by courts and prosecutors, and to a less frequent extent

legislators, that society benefits by deterring future bad conduct and by removing the current or recent past violators from their positions of power. "Put away the worst actors and you send a message to their peers" is one way to express this phenomenon.

2:2 WHAT MANIFESTS THE EXISTENCE OF THE PROBLEM?

This text is not a classical "black letter hornbook," and so we have reached out for discussions of this problem in nonlegal sources. In the footnotes supporting this text, we use a variety of news sources, articles, and nontraditional references beyond the classic legal case reports. The volume of public discourse about corporate crime has increased with highly visible stock and investment fraud cases and with the mortgage-related financial problems of 2007–2009 and beyond.

Criminal punishment is a statutory decision made by elected legislators; to a lesser extent, punishment terms are crafted from policies of elected or appointed attorneys general. Both respond to the perception that a problem exists. A political observer would note that a "problem" reaches the Congress through the complaints of constituents, who in turn reach the media, who in turn reached other political figures to connect to the legislators. A Congressman from a region whose residents lost pension funds because of a corporate collapse is far more likely to be sponsoring laws for "tougher penalties for corporate crimes" than are other legislators. Our coverage of "misconduct" is intended to reach what some may consider a "problem," while others would consider it overreaction to accidents, spills, building fires, or business investment mistakes. Punishment is a societal decision, and there is no unanimity about when and to what extent to punish corporate misconduct.

History notes that the same action could be lauded in one society and condemned in another, or within the same society at different times. Discarding sludge from the bilges of a barge might be exactly what was routinely done in one era, though it would be prosecuted today. Crews wrecking an old warehouse building in a cloud of dust might have been normal for many years; today the failure to remove and abate asbestos dust is unacceptable and criminally proscribed.

In the context of this book, we address the means of punishment, the alternatives and the ways in which defenders and prosecutors deal with potential sentencing and potential alternatives. The reader should keep in mind that punishing organizations that violate laws is an issue that would draw considerable public support among voters, and for that reason, the wider and deeper scope of corporate criminal statutes in recent years has not produced a negative backlash among voters. The public wants more prosecutions of more actions, and the legislators have responded. Our text addresses not the "why" but the "how much," "how strong," and "how to avoid" issues.

2:3 HOW SIGNIFICANT IS THE PROBLEM OF CRIMINAL MISCONDUCT BY CORPORATIONS?

After a diligent research effort, we found no reliable empirical data about the total numbers of incidents in which a corporation or organization has violated a statutory prohibition. No one can accurately count the incidents and the actors for which a criminal indictment or information could have been filed against the organization. We believe that simply counting the numbers reported as indictments or convictions would be misleading. A small number of disputed fact situations will be prosecuted each year by the U.S. Department of Justice or by state "white collar crime" teams. A review of the press releases by federal criminal prosecutors is one of the few metrics available, and even this imperfect survey demonstrates increased attention to punishing corporate defendants.¹

Decisions not to use criminal punishments are frequently made by regulatory agencies for various reasons. For example, serious violations of the Federal Food, Drug, and Cosmetic Act occurred in 2007, but zero cases were referred for criminal prosecution. The political appointments made to that agency's leaderships from industry advocates may have skewed the data points, but they did not eliminate the reality that some corporations did violate the law, but avoided criminal consequences. Other regulators decide not to use criminal statutes because of the delays in court dockets and the complexity of "proof beyond a reasonable doubt."

2:4 HOW HAS THE LAW DEALT WITH CORPORATE CRIME?

Although the focus of this book is on punishment mechanisms and not on the esoteric points of criminal law, it helps to have background about the American legal system's approach to crime and punishment. The Model Penal Code of the American Law Institute noted that corporate criminal punishment "is of comparatively recent origin, the modern development having occurred almost entirely within the last century and a quarter." Most of the resistance to punishing corporate entities was the argument that an entity has no intent, no mens rea underlying the illegal action. This theory faded with the recent decades; trends apply criminal penalties once it is shown that the agents, such as the corporate officer, acted with intent and caused harm. It was enough that "those in positions of managerial authority or responsibility acted or failed to act in such a manner that the criminal activity reflects corporate policy, and it can be said, therefore, that the criminal act was authorized or tolerated or ratified by the corporation."

The Model Penal Code formula, followed in numerous state criminal statutes, focuses on the board of directors or "a high managerial agent acting in behalf of the corporation within the scope of his office or employment." If he, she, or they has "authorized, requested, commanded, performed or recklessly tolerated" the act, then the corporation can be held liable.⁴

DEFINING THE PROBLEM

¹ http://www.usdoj.gov/usao/offices/index.html.

² ALI, Model Penal Code, Comment to 2.07 (1985).

³ State of Minnesota v. Christy Pontiac-GMC Inc., 354 N.W.2d 17 (Minn. 1984).

⁴ ALI, Model Penal Code, §2.07 (1985).

2:5 WHAT ARE THE CONSTITUTIONAL CONSTRAINTS SURROUNDING THIS PROBLEM?

Congress and state legislatures are limited in their ability to punish misconduct by the terms of the federal and state constitutions. The Bill of Rights has a central role in fixing the bounds for police activity and for prosecutors' activities. Criminal due process rights apply under the Fifth Amendment, but with certain exceptions. Fourth Amendment constitutional rights apply to protect both individuals and corporations against "unreasonable" searches and seizures.

The Eighth Amendment degrees of punishment are the most relevant to this book. Case law suggests that the punishment issues for corporations will be affected by Supreme Court decisions that the federal Sentencing Guidelines are no longer mandatory,⁵ as well as by the Court's willingness to suppress claims for large punitive damages in tort cases on constitutional grounds of due process and excessive fines clauses.

The Sixth Amendment's promise of a jury trial is applicable to organizations in some cases, but not in all trials that involve corporate defendants because some will involve minor penalties.⁶ Sentencing Guidelines for organizations have been affected by the Supreme Court's interpretation in the *Booker* case, and this in turn has affected the reasoning for denial of jury trials in some corporate punishment cases.⁷

2:6 WHAT ARE THE ELEMENTS OF THE STATUTES CREATING CRIMINAL OFFENSES?

Legislative bodies adopt statutory standards of criminal liability from several sources: Model Penal Code⁸ or Uniform Laws⁹ standards; state versions of federal laws creating crimes; examples from laws adopted in other states; or the home-grown criminal statute that addresses one particular undesired behavior within that state. In rare cases, the state appellate courts describe the weaknesses of a particular statute and the legislators pay attention, revising the statutes according to the judicially perceived weaknesses.

Interpreting corporate criminal penalty statutes follows a similar pattern in most states and most situations. These are known as *elements of the offense*. The acts that are prohibited are named; the level of intention required for the offense, sometimes called *mens rea*, is described; and the persons who are subject to the prohibition are named if specific classes of persons are to be covered.

10 PROF. JAMES T. O'REILLY

⁵ U.S. v. Booker, 543 U.S. 220 (2005).

⁶ Intl. Union, United Mine Workers v. Bagwell, 512 U.S. 821, 838 (1994).

⁷ Timothy Johnson, Sentencing Organizations After Booker, 116 Yale L. J. 632 (2006).

⁸ Created by the American Law Institute, updated periodically.

⁹ Created by the National Conference of Commissioners on Uniform State Laws.

Of these, the level of intention required to be shown for conviction is the focal point of much debate in appellate reports. In environmental crimes, prosecutors take the position that general intent, i.e., doing an act deliberately and not accidentally, is sufficient for criminal liability. These "public welfare offenses," like food and drug violations, have been treated differently from typical crimes because the law imposes extra responsibility for entities engaged in sensitive health protection roles. ¹⁰ So they make the requirement for proof of intent or mens rea very low, convicting the defendant corporate official even where he or she may not have been precisely aware of the applicable regulation being violated by the action.

The classical rule before the 1962 Model Penal Code had been that the corporation is liable for criminal acts of its employees and agents, if (1) done within the scope of their employment, (2) with the intent to benefit the corporation, and (3) even without proof that the act was expressly authorized or approved by the corporation. ¹¹ The corporation may be held responsible, even though its employees or agents acted contrary to express instructions when they violated the law, so long as the agents acted for the benefit of the corporation and within the scope of their actual or apparent authority. Actions by corporate employees outside the scope of their employment for their sole benefit are not imputed to the corporation, but there is no requirement that the agent be working for the exclusive benefit of the corporation, in order to impose corporate criminal liability. ¹²

Corporations are legal entities that have no human brain but do have responsible officials and agents who can intentionally act, or knowingly act, in a certain manner. The statute can define the violative act as being done by the corporation, although everyone knows that the act is done by human agents acting in the name of the corporation. A corporation can be convicted for actions committed by its agents, so long as the agents were acting within the scope of their actual or apparent authority, and this is so even if it had expressly instructed the agents not to engage in criminal conduct. Imagine an environmental crime statute that a state legislature adopts after a recent groundwater contamination leakage by a company, a leak that has impacted on a region's water supply wells: "Whoever, being owner of a Class I landfill as defined in Code Section XX, knowingly accepts hazardous waste into such landfill, shall be guilty of a Category 4 felony." The rule of lenity applies for the benefit of the criminal defendant: the law is interpreted in a manner that favors the criminal defendant, in the case of any ambiguities. In the case of any ambiguities.

DEFINING THE PROBLEM 11

¹⁰ U.S. v. Park, 421 U.S. 658 (1974).

A useful historical comparison to the Model Penal Code formulation is given in Pamela Bucy, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 MINN. L. Rev. 1095, 1102 (1991).

¹² See, e.g., U.S. v. Wagner, 29 F.3d 264 (7th Cir. 1994).

¹³ State v. Zeta Chi Fraternity, 142 N.H. 16, 696 A.2d 530 (1997).

The rule of lenity holds that in construing an ambiguous criminal statute, the court should resolve the ambiguity in favor of the defendant. *See McNally v. United States*, 483 U.S. 350 (1987).

2:7 WHAT HAS BEEN THE HISTORY OF CRIMINAL PUNISHMENT OF ENTERPRISES IN AMERICA?

The classic Supreme Court cases have held that corporations can be subjected to criminal penalties, for acts done by its agents within the scope of their employment and with intent to benefit the corporation. There is no doubt that a criminal penalty can be imposed on a corporation. How much the corporation's liability is attributable to misconduct of employees, at what level and with what intention, is the issue that the Model Penal Code and state statutes have explored, as discussed throughout this text. The degree to which certain internally gathered information can be subpoenaed and used against the corporation has been disputed as well. The liability of the corporation is separate from individual liability of employees; 17 each may be held liable, and conviction of the officers is not a bar to prosecution of the corporation. 18

A corporate entity cannot be imprisoned the way an individual's liberty can be restrained, though in rare cases a court might try to so, by preventing continued misconduct.¹⁹ In today's corporate crime setting, a management team that caused the violation might be subjected to the presence of a monitor or a receiver, who provides direct supervision under the powers of the court.²⁰ This person will be expected to act as an equivalent restraint on the customary freedom of action for that corporation, a rough equivalent to an impairment of the freedom of a corporate "person."

An interesting subset of the case law has been the "collective knowledge" line of appellate precedents. The problem was finding the mens rea (criminal intention) of the inanimate corporation. The response was the First Circuit's decision that, even though no human employee had been shown to have mens rea, knowledge of the criminal activity "obtained by corporation employees acting within the scope of their employment is imputed to the corporation." Because the corporation compartmentalizes its knowledge among departments and officials, the "aggregate of those components constitutes the corporation's knowledge of a particular operation." Later cases ascribe the liability situation to "intentional or reckless disregard of a legal duty," so the doctrine may best be used where managers made efforts to avoid "knowing" about the illegal acts. The commentators have diverged on the wisdom of this

12 PROF. JAMES T. O'REILLY

¹⁵ New York Cent. & H.R.R. Co. v. U.S., 212 U.S. 481, 29 S. Ct. 304, 53 L. Ed. 613 (1909); U.S. v. Bi-Co Pavers, Inc., 741 F.2d 730, 16 Fed. R. Evid. Serv. 421 (5th Cir. 1984).

¹⁶ Upjohn v. U.S., 449 U.S. 383 (1981).

¹⁷ U.S. v. Griffin, 401 F. Supp. 1222 (S.D. Ind. 1975), aff'd, 541 F.2d 284 (7th Cir. 1976).

¹⁸ Com. v. J. P. Mascaro and Sons, Inc., 266 Pa. Super. 8, 402 A.2d 1050 (1979).

U.S. v. Alleghany Bottling Co., 695 F.Supp. 856 (E.D.Va. 1988), remanded, 870 F.2d 655 (4th Cir., 1989).

²⁰ See infra Chapter 10.

²¹ U.S. v. Bank of New England, 821 F.2d 844, 856 (1st Cir. 1987).

²² Id. at 856.

²³ U.S. v. Aversa, 984 F.2d 493, 498 (1st Cir. 1993).

approach.²⁴ While there are other examples of the collective knowledge doctrine,²⁵ involving degrees of corporate employee awareness,²⁶ the criminal cases articulating the doctrine have been relatively few. More often the cases involve administrative agencies like the U.S. Securities and Exchange Commission and civil securities litigation.²⁷

2:8 HOW HAS THE RISE OF DETERRENT AND PREVENTIVE CRIMINAL SANCTIONS IMPACTED ON CORPORATIONS?

The prudent corporations are well aware of the risks of misconduct. Names like Enron, WorldCom, Tyco, and other criminal defendants come to the mind of every intelligent corporate manager. Martha Stewart's stock trades made biotech startup ImClone into a very well-known firm, albeit one associated with a different kind of cell. The effects of implementing recent changes in corporate governance of publicly held corporations following adoption of the Sarbanes-Oxley Act (SOX)²⁸ are well covered in multiple sources. The SOX legislation has spurred the boards of directors of American corporations to devote extra effort to structural changes that will (hopefully) detect, report, and avoid the consequences of criminal misconduct.

Cost impacts of avoidance from being a criminal defendant have been marginal in some firms and substantial in others. Total indirect costs have been large, if one counts the opportunity costs of a prudent management's choice of not pursuing immediate profit through exploitation of dubious schemes. Staffing the corporate offices with compliance specialists, establishing self-reporting hotlines, training workers on ethical expectations, and other acts of prevention have become well recognized as means of reducing executive and board liabilities. These are parts of the overhead cost of administering a compliant corporation today.

If the internal programs work as they have been designed, they will help to isolate illegal activities, bring it to the attention of the company managers, and stop the misconduct early before it can do significant damage. Self-reporting and self-auditing may follow; such programs are especially important in the avoidance of harsh penalties under the federal Sentencing Guidelines. More broadly, business schools now include ethics training, and integrity and ethics officers have been appointed at some corporations. Predictably, some companies that ignore ethical constraints are more

DEFINING THE PROBLEM 13

Martin Weinstein and Patricia Ball, *Criminal Law's Greatest Mystery Thriller: Corporate Guilt Through Collective Knowledge*, 29 New England L. Rev. 65, 78 (1994); Thomas Hagemann and Joseph Grinstein, *The Mythology of Aggregate Corporate Knowledge: A Deconstruction*, 65 Geo. Wash. L. Rev. 210, 236 (1997).

²⁵ U.S. v. TIME-DC Inc., 381 F.Supp. 730, 733 (W.D.Va. 1974).

²⁶ *Id.* (degree of employee and manager awareness probed).

²⁷ In re Worldcom Inc. Securities Litigation, 352 F.Supp.2d 472 (SD NY 2005).

²⁸ Pub. L. 107–204, 116 Stat. 745 (2002).