Introduction

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Corporate crimes occur all too often, causing serious harm to individuals, as well as to the economies of countries adversely impacted by crimes such as fraud and corruption. Crimes by large publicly-held firms raise special concerns because these firms have such a broad reach that they can cause tremendous harm when their employees pursue profit through criminal activities. To guard against these harms, criminal laws and regulations impose duties on corporations and those who work for them to avoid a range of harmful activities. Laws in the U.S., and in many other countries, impose criminal and civil liability on both individual wrongdoers and their corporate employers for violations of these duties. The central purpose of this liability is—and must be—to deter corporate misconduct.

Deterrence should be the primary goal of corporate and individual liability for corporate misconduct for a simple reason. Any provision that sacrifices deterrence in the name of some other goal, such as retribution, leads more people to be harmed by corporate crime. Thus, pursuing retribution at the expense of effective deterrence places future victims in harm's way. Deterrence, by contrast, both helps safeguard future victims and reduces the need for future punitive interventions.

In addition, when misconduct is caused by employees of publicly-held firms, there is an additional reason to favor enforcement policies that deter misconduct over those that punish the firm: corporate liability imposed on publicly-held firms is hard to justify as a means to punish wrongdoers. Corporate liability ultimately falls on the firm's shareholders. Yet shareholders of professionally-managed firms rarely play any role in causing misconduct; nor do they have sufficient management power to prevent misconduct (Arlen 2012; Arlen and Kahan 2017).¹ Instead, public corporations' acts and intent are really the acts and intent of employees who often have little stake in the firm. These employees often act primarily to benefit themselves (often indirectly through the compensation or job security that follows actions that confer a short-run benefit on the firm). The actions of these employees are only incompletely controlled by, and known to, those above them, even in firms with effective compliance programs. Thus, it does not seem appropriate to seek retribution against a publicly-held firm for most of the types of crimes they commit.

By contrast, strong reasons exist to impose liability on corporations in order to deter corporate crime. Properly structured corporate liability can provide corporations—and in turn the managers and directors who control the firm—with incentives to intervene

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¹ For example, under Delaware law (which governs the majority of U.S. publicly-held firms), the power to manage the firm is vested in the board of directors, not the shareholders. Delaware General Corporation Law 141(a). Shareholders can vote for the board of directors, but in most firms they cannot vote to nominate which candidates are put before them for election. They have little, if any, genuine control over the firm.

efficiently to deter corporate crime. Corporations are vital to the effort to deter corporate crime because they control the benefit that employees derive from crime (through control over compensation and promotion policies). They also directly impact the expected cost of crime to their employees. Corporations can increase their employees' expected cost of crime through interventions that increase the government's ability to detect and sanction crime. These interventions include adopting an effective compliance program, investigating suspected misconduct, self-reporting detected violations, and fully cooperating to provide the evidence needed to convict responsible individuals (hereinafter "corporate policing"). Corporate policing is important because, absent corporate policing, employees engaging in misconduct often do not fear criminal punishment because they think the government is unlikely to detect the crime or identify the individuals responsible. Firms can help detect crimes and identify the wrongdoers if motivated to do so.

Of course, firms will intervene to deter corporate crime only if they have an incentive to do so. The threat of criminal or civil liability for employees' crimes can provide this incentive, if properly structured. Corporate liability must be structured to ensure that firms which have effective compliance programs, self-report and cooperate fare better than those that do not. In addition, the government must use the information produced by corporate cooperation to hold individual wrongdoers liable for the crimes they committed. After all, absent the threat of personal liability, employees will continue to commit corporate crimes.

U.S. enforcement policy is evolving, adopting an increasing number of features that could help deter corporate crime. Prosecutors are encouraged to insulate firms that self-report and cooperate from formal conviction through the use of deferred and non-prosecution agreements (DPAs and NPAs). DPAs are criminal settlements that enable prosecutors to sanction firms and obtain admissions of criminal responsibility without a formal conviction. Prosecutors also adjust sanctions and mandates in response to corporate activities, including the effectiveness of the firm's compliance program and thoroughness of the investigation. Enforcement officials can use policies governing the availability of DPAs and NPAs, as well as sanction mitigation, to incentivize firms to self-report and cooperate (Arlen 2012). In addition, enforcement authorities negotiating with managers who are not committed to deterrence can enhance deterrence by using corporate criminal settlements to require firms to undertake specific reforms or to accept a monitor (Arlen and Kahan 2017).

The reforms that have transformed the U.S. system have raised a host of issues, however. These include questions about whether liability does in fact deter, whether criminal and civil liability are appropriately targeted at those responsible for the misconduct, the impact on enforcement policy and deterrence of having multiple enforcers, the potential deterrence role of whistleblowers, the most effective approach to compliance, and the complex task of conducting a corporate investigation in the modern age. The chapters in this book address these issues.

OVERVIEW OF THIS VOLUME

This book brings together leading scholars from a variety of disciplines to explore mechanisms for deterring corporate crime and securities fraud through both public

enforcement and private interventions. The book is divided into three parts: Part I: Corporate and Individual Liability for Corporate Misconduct; Part II: Public Enforcement of Public Corruption and Securities Fraud; and Part III: Role of Private Actors: Compliance, Corporate Investigations, and Whistleblowing.

Part I examines corporate and individual liability for corporate misconduct through four chapters that consider the causes of corporate crime, empirical analysis of public enforcement, the liability of supervisors, and the potential cost to corporations of reputational damage from corporate criminal settlement.

In Chapter 1, “Psychology and the deterrence of corporate crime,” Tom Tyler reviews the effectiveness of deterrence, in and of itself, as well as relative to the influence of consensual models of regulation that rely upon legitimacy to motivate compliance. The law governing corporate criminal enforcement, and the law and economics scholarship designed to inform it, treats deterrence as the primary goal, and coercion through threatened sanctions as the most effective tool to achieve this goal. Yet, according to Tyler, the available evidence on the causes of misconduct suggests that although people do respond to threatened sanctions, the influence of coercion is often overstated relative to its actual influence upon law-related behavior. In addition, consensual approaches have been found to be more effective than is commonly supposed. Taken together these findings suggest the desirability of developing a broader approach to corporate regulation using both coercive and consensual models of regulation. Given the strength of the findings for consensual models, the persistence of coercive models as the dominant and even exclusive approach to corporate crime is striking. That dominance suggests the importance of focusing on the psychological attractions of coercion to people in positions of authority. Tyler suggests that those in authority are attracted to this approach not only because of evidence that it can be effective but also due to the psychological benefits it affords them.

In Chapter 2, “Individual and corporate criminals,” Brandon Garrett examines whether corporate enforcement actions are indeed leading to the eventual prosecution of the individuals responsible for the crimes. He finds that officers and employees are only prosecuted in about one-third of the federal corporate criminal settlements involving deferred or non-prosecution agreements. Garrett’s chapter explores possible reasons for this pattern. Using the HSBC case as an example, Garrett first introduces the practical and procedural obstacles that arise in cases involving both organizations and employees. Turning to the evidence on individual prosecutions in corporate cases, Garrett then explores why prosecutors so frequently do not or cannot prosecute individuals in corporate cases, and why they so often achieve limited success when they do. Garrett concludes by describing alternative means to deter individual behavior and what significance this has for the approach to corporate prosecutions more generally.

In Chapter 3, “Criminally bad management,” Samuel Buell extends the analysis of individual liability by shining the spotlight on the corporate managers who often play a vital role in either inducing crime on the one hand or deterring it on the other. After all, it is managers that produce the corporate culture that can either operate to cause crime or to deter it. Buell explores the challenges and potential promise of using criminal liability to impose sanctions on managers who were indirectly responsible for a crime but did not commit any acts to help commit it.

In Chapter 4, “Does conviction matter? The reputational and collateral consequences of corporate crime,” Cindy Alexander and Jennifer Arlen evaluate the claim made by

some critics of DPAs that the use of DPAs undermines deterrence by lowering the cost to firms of the reputational damage or stigma resulting from a criminal settlement. Criminal settlements cause firms to sustain costs from reputational damage when they release information that leads interested outsiders—e.g., customers and suppliers—to anticipate an enhanced risk of harm from future dealings with the firm. DPAs alter this cost if, but only if, they affect the information released by the criminal settlement about the firm's expected risk of causing future harm. The authors evaluate, and reject, three potential channels through which the choice of settlement form could affect the information about future risk reaching interested outsiders: direct revelation, prosecutorial selection, and managerial selection. They then turn to the impact of DPAs on the ability of federal agencies to protect their interests by excluding or delicensing firms whose criminal settlement reveals that they present an enhanced risk of causing future harm to the agencies' interests that is best addressed by exclusion instead of by mandated reforms. They conclude that agencies may be better able to serve their interests as interested outsiders when prosecutors employ DPAs rather than pleas because DPAs leave agencies free to use permissive exclusion and enable them to exclude when, but only when, appropriate.

Part II presents five chapters focused on public enforcement of public corruption or securities fraud. Chapters 5–7 examine three different aspects of liability for corruption. Chapters 8 and 9 examine Securities and Exchange Commission enforcement of securities fraud.

In Chapter 5, "Multijurisdictional enforcement games: the case of anti-bribery law," Kevin Davis provides an economic analysis of corporate criminal enforcement for crimes, such as corruption, whose enforcement involves multiple agencies, often based in different jurisdictions. Davis shows how the interaction between the multiple enforcement agencies can be analyzed as a dynamic multi-player game in which the players include both enforcement agencies and firms. He finds that this kind of analysis can be used to formulate testable hypotheses about the outcomes of interactions between regulators and firms. Unfortunately, opportunities to evaluate these kinds of hypotheses empirically are limited because many aspects of the structure of the game are difficult to observe, and firms' misconduct and regulators' enforcement activities typically are only observable when they result in formal sanctions. The chapter concludes with a discussion of some of the challenges inherent in normative analysis of the outcomes of multijurisdictional law enforcement games.

In Chapter 6, "Beware blowback: how attempts to strengthen FCPA deterrence could narrow the statute's scope," Matthew Stephenson argues that proposed reforms to the Foreign Corrupt Practices Act (FCPA) intended to deter FCPA violations more effectively—such as creating a private civil remedy, more aggressive targeting of individual defendants, and expanded use of corporate debarment—could have the opposite effect. According to Stephenson, such reforms might lead to a substantive narrowing of the FCPA, because they would lead to more litigation, much of it against more sympathetic defendants, and this in turn could lead to both judicial narrowing of ambiguous statutory terms and Congressional revisions to the statute. He concludes that the possible unintended consequence should be considered when conducting a more comprehensive evaluation of the costs and benefits of proposed FCPA reforms.

In Chapter 7, "Corruption in state administration," Tina Søreide and Susan Rose-Ackerman analyze the other side of the corruption equation: the supply of corrupt

decisions by government officials. Specifically, they provide an economic analysis of corruption as a trade in decisions that should not be for sale. The size of the bribe and the consequences of corruption are functions of the bargaining powers of those involved. They suggest ways to reorganize decision-making procedures to reduce the risks of corruption but stress the difficulty of breaking up entrenched collusive environments. Furthermore, even if corruption in a public institution is well recognized, it may not be possible to identify individual offenders. The question then is whether one should sanction the entire public body. Like private entities, public institutions can be encouraged to self-police and self-report (for example, upon information from a whistleblower) if such steps will reduce the extent of some penalty. However, the criminal and administrative monetary sanctions applied to private sector entities are a poor fit for state institutions with ongoing responsibilities to the citizenry. They propose non-monetary penalties, including intensified external monitoring, reorganization of authority, disqualification of leaders, and removal of service provision responsibilities.

Chapters 8 and 9 both consider aspects of public enforcement of financial misrepresentation by the Securities and Exchange Commission (SEC). In Chapter 8, “Securities law and its enforcers,” Stephen Choi and A. C. Pritchard review the existing empirical literature relating to government enforcement of the securities laws, particularly by the SEC, including comparative work, assessment of the impact of enforcement, and analysis of enforcement patterns. Choi and Pritchard also identify a particularly promising area for future research. Little work has been done to date exploring the incentives faced by attorneys who conduct investigations on behalf of the SEC and how those incentives shape enforcement decisions. This chapter offers preliminary evidence on the career paths of SEC lawyers and how those career choices might influence the enforcement actions brought by the SEC.

In Chapter 9, “Corporate and individual liability in SEC enforcement actions,” Michael Klausner and Jason Hegland present an empirical analysis of SEC enforcement. Some commentators have accused the SEC of going easy on executives responsible for securities fraud and instead penalizing shareholders by imposing fines on corporations. The authors investigate that claim empirically and conclude that it is unsupported. The SEC frequently penalizes executives; it imposes monetary sanctions on corporations far less often. The chapter goes on to provide more detail on SEC practice with respect to penalizing corporations and executives in cases alleging disclosure violations by public companies.

Part III contains five chapters that examine the role of private actors in deterring corporate crime. These private interventions include actions taken by corporations—such as compliance and internal investigations—as well as whistleblowing by employees and others.

In Chapter 10, “An economic analysis of effective compliance programs,” Geoffrey P. Miller examines the core features of effective compliance. Tests for “effective” compliance programs take the form of lists specifying required elements in varying levels of detail. From an economic perspective, an effective compliance program can be defined more fundamentally as the set of policies and procedures that a rational, profit-maximizing firm would establish if it faced an expected sanction equal to the social cost of violations. Miller explores the idea and several of its extensions and qualifications.

In Chapter 11, “Behavioral ethics, behavioral compliance,” Donald Langevoort analyzes the promise of taking a behavioral approach to compliance and ethics. Research

in psychology and organizational behavior under the heading of “behavioral ethics” is growing rapidly, offering new insights into how people (individually and in groups) choose whether to comply with legal and ethical norms. In legal scholarship, a robust literature is emerging on the subject of organizational compliance, as public enforcers become more insistent that corporations build and maintain state-of-the-art systems. This chapter joins these two bodies of research, demonstrating the potential payoffs—and challenges—in using a behavioral frame of reference to assess compliance risks, design appropriate interventions, and communicate more effectively about both law and ethics with corporate managers and other employees. Just as compliance requires good economics skills, it requires psychological savvy as well, to help predict how incentives and compliance messages will be processed, construed and acted upon in the field.

In Chapter 12, “An analysis of internal governance and the role of the General Counsel in reducing corporate crime,” Vikramaditya Khanna reviews the empirical literature on the factors related to the likelihood and detection of corporate wrongdoing, which increasingly focuses on internal governance, and examines calls to split the traditional tasks of the General Counsel (GC) between the GC and a Chief Compliance Officer (CCO) who reports directly to the Board. The reason for this is to have more independence and expertise in compliance matters than the GC’s office traditionally provides. Khanna argues that although independence is often valuable in reducing wrongdoing, in this context it is likely to come with additional costs that may make gathering information on wrongdoing more difficult. In particular, some employees may be more reluctant to provide information to a CCO than to the GC, and this may result in increased wrongdoing and weaker operating performance. These deleterious effects, however, might be somewhat ameliorated by institutional and governance design adjustments. Khanna examines what factors may drive likely outcomes and finds that further empirical inquiry would be valuable, going on to suggest some ways in which future research might engage in this inquiry.

In Chapter 13, “When the corporation investigates itself,” Miriam Baer evaluates the challenges corporations face when investigating corporate crimes in the shadow of the federal government’s expectations concerning full corporate cooperation. She argues that the corporate investigation’s greatest challenges stem from familiar problems of individual and entity-level efforts to evade detection. As employees take steps to conceal their misbehavior, corporate actors must navigate a difficult relationship between government enforcers on the one hand and corporate employees on the other. Mediating these relationships would be difficult enough under any circumstance, but a vexatious deficiency of trust between corporate actors and government enforcers causes corporate actors to cling ever more intently to legal doctrines such as the corporate attorney–client privilege, while simultaneously conducting more intensive, intrusive and expensive investigations. Baer concludes by noting two developments: the Department of Justice’s latest attempt to secure cooperation from corporate defendants in identifying culpable employees (the so-called “Yates Memo”), and the increasing emphasis on workplace privacy. These two developments will place even greater pressure on the corporate investigator as she attempts to reassure the corporation’s employees and regulators that each side can in fact trust the corporation to investigate itself thoroughly yet fairly.

In Chapter 14, “Bounty regimes,” David Freeman Engstrom offers a theoretical and empirical overview of whistleblower bounty schemes that pay individuals a cash “bounty”

for surfacing information about illegal conduct. Engstrom first catalogues existing bounty regimes by comparing the structure and workings of two of its most prominent exemplars: the False Claims Act and the more recent Dodd-Frank whistleblower scheme. Next, he surveys the existing scholarly literature, with particular attention to a trio of recurrent design problems. Among these are how to incentivize an optimal level of reporting, how to harmonize bounty regimes with internal corporate compliance systems, and how to weigh efficiency and democratic-control concerns when deputizing whistleblowers to do regulatory work. Finally, he turns to an aspect of the regulatory design puzzle that has yet to attract substantial attention: how the organizational structure of wrongdoing (e.g., organizational complexity, the degree to which the misconduct is centralized or compartmentalized, and the like) presents opportunities and challenges in the design of bounty regimes. He concludes that it is here that scholars are most likely to find fruitful avenues for further research.

Taken together, the chapters in this volume both reveal how far we have come in our understanding of mechanisms for deterring corporate misconduct and highlight promising avenues for future research.

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