5 Vicarious and corporate civil liability

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5.1 Introduction

‘Vicarious liability’ is the absolute liability of one party – generally the legal ‘principal’ – for misconduct of another party – her ‘agent’ – the actor whose activities she directs. As such, traditional vicarious liability is a form of strict secondary liability, in contrast to secondary liability imposed on principals or other parties under a duty-based standard such as negligence. In the common law, the legal doctrine of *respondeat superior* is the principal vehicle for holding principals liable for the torts and other delicts of their agents. Under this doctrine, principals are jointly and severally liable for the wrongs committed within the ‘scope of employment’ by agents whose behavior they have the legal right to control (‘servants’). For the US, see Restatement (Second) of Agency, §§2, 219 (1958), 220, 229; and Restatement (Third) of Agency, § 7.07 (2006). Not only is English law similar (Rogers, 2002), but most Civil Code jurisdictions have inherited an almost identical rule of vicarious liability for torts from article 1384 (subsection 3) of the Napoleonic *Code Civil* of 1804. See generally, Spier (2002).

Thus, most corporate liability for torts, and in the United States for corporate crimes as well, is vicarious liability imposed under *respondeat superior* or its civil law analogues. To be sure, corporate liability may also be direct, as when the independent actions of several corporate agents cumulatively result in a business tort, although no single agent is individually culpable. But even in this case, the liability of corporate principals is best conceptualized as vicarious liability for the failure of the firm’s management to supervise its employees.

An overview of the literature on vicarious and corporate civil liability must address at least six areas of commentary: (a) the standard case for strict vicarious liability; (b) the factors militating against vicarious liability; (c) the interaction between vicarious liability and the structure of liability for agents; (d) alternatives to a strict vicarious liability standard; (e) alternative targets for vicarious liability; and (f) the choice between civil and criminal corporate liability.

5.2 The standard case for vicarious liability

The initial issue raised by a regime of vicarious liability for torts is the Coasian question: why should an allocation of liability between principals and agents matter if these parties are able to reallocate liability among themselves by agreement? The fundamental analysis of vicarious liability, developed with the aid of principal–agent models by Kornhauser (1982) and Sykes (1981, 1984), looks to the insolvency of agents and to the limitations on the ability of the parties to shift liability as the basic conditions favoring vicarious liability. As a general matter, Kornhauser (1982), Sykes (1984) and Shavell (1987) agree that vicarious liability for ordinary torts is more likely to increase social welfare as the disparity between agent assets and the magnitude of prospective tort liability increases. By contrast, where tort liability would leave both principals and agents solvent and the costs of negotiation between principals and agents are slight, vicarious liability is likely to have few efficiency consequences (see, for example, Kornhauser, 1982, pp. 1351–2; Sykes, 1984, p. 1241). Nevertheless, when principals are knowledgeable about tort risks and agents are not, vicarious liability can be efficient even if both parties are solvent – as when, for example, principals can monitor their agents but cannot convey their knowledge of risk to their agents directly.¹

Given that principals can satisfy prospective tort liability but agents cannot, vicarious liability may or may not be efficient. Consider first the considerations that weigh in favor of vicarious liability when agents are insolvent but corporate principals are not.

To begin, the likely efficiency of vicarious liability increases with the ability of principals to monitor and control agent risk-taking. The analysis is straightforward. Absent vicarious liability, personal liability gives insolvent agents insufficient incentive to take care, since they lack the wealth to pay tort damages (Sykes, 1981, p. 168; Shavell, 1987, pp. 170–171). Moreover, their principals have no incentive to urge greater care, since the only liability cost they face (in the absence of secondary liability) is the wage expense of offsetting agents’ expected liability costs – which, by assumption, are small. Thus, under a regime of purely personal liability, insolvent agents will lead firms that are otherwise able to monitor their agents to take too little care and/or to initiate too much risky activity or misconduct. By contrast, these principals will seek to control their agents to ensure optimal precautionary measures if they are vicariously liable.

¹ Shavell (2007) offers the example of holding a parent vicariously liable for a motorboat accident caused by a teenage child who is unaware of the hazards associated with operating motorboats.
for their agents’ actions. Correlatively, of course, vicarious liability is less likely to be efficient if principals are poor monitors of their agents’ behavior (see, for example, Epstein and Sykes, 2001; Shavell, 2007; and Posner and Sykes, 2007).

The traditional doctrine of *respondeat superior* fully accords with this analysis by linking vicarious liability explicitly to the principal’s costs of monitoring or otherwise controlling employee behavior (Landes and Posner, 1987, p. 208). For example, agency law determines the principal’s tort liability based not only on her capacity to monitor her agent’s actions but also on her ability to contractually alter her agent’s incentives, as when the scope of employment rules condition vicarious liability on whether the culpable agent acted, at least in part, to benefit his principal (Restatement (Second) of Agency, 1958, § 228(1)(c); Restatement (Third) of Agency, 2006, § 7.07(2)).

Apart from inducing principals to control agent misconduct through monitoring and preventive measures, vicarious liability can also force principals to internalize the costs of misconduct when agents are judgment proof. All else equal, forcing firms to internalize the costs of corporate misconduct leads to an efficient scale of production as private costs come to equal the social costs of firm activity (see, for example, Shavell, 1980; Kramer and Sykes, 1987, p. 286). Thus, even if principals cannot control caretaking by their agents, vicarious liability ensures that they at least face the full expected costs of wrongdoing, and so do not undertake too much risky activity — providing, of course, that their agents are also strictly liable for the underlying harms at issue (Polinsky and Shavell, 1993).

As Shavell (1987, pp. 173–4) notes, moreover, several other considerations also favor a rule of vicarious liability. First, as mentioned earlier, principals may be better informed than agents about accident risks, or better able to limit these risks by reorganizing the workplace. Second, principals — and particularly firms — may be better able to monitor and discipline agents than the courts. Thus, vicarious liability may be socially advantageous if principals are less likely than courts to err in reviewing agent conduct. Third, principals may be more attractive targets of liability as a consequence of what Kornhauser (1982, pp. 1370–71) terms the problem of ‘multiple agents’. That is, an outside plaintiff may find the task of determining which of a firm’s many agents has caused a tort extremely costly, even when one of the firm’s agents is clearly responsible. But if the firm faces liability, it may be able to locate and discipline the culpable agent — or, even if it cannot, it may be able to reduce tort costs through other means such as training programs or screening measures. Fourth, as most commentators acknowledge, shifting liability to principals under a vicarious liability rule is likely to reduce risk-bearing costs, at least in the
paradigmatic case where agents are risk averse or insolvent, principals are firms, and victims are risk-averse individuals (for example, Kramer and Sykes, 1987, p. 278; Chapman, 1996).

Finally, in addition to the justifications for vicarious liability resting on the assumption of rational, utility-maximizing actors, some commentators have proposed justifications based on limited or defective rationality, particularly on the part of corporate agents (for example, Croley, 1996; Schwartz, 1996a). In these accounts, defective rationality blunts the incentive effects of liability on wayward agents, much as insolvency, or external constraints on sanctions, can limit the power of liability to deter agents in more conventional accounts of vicarious liability.

5.3 Factors militating against strict vicarious liability

Although the preceding considerations make a persuasive case for imposing vicarious liability in many circumstances, they also point to several factors that weigh against doing so. Agents who are knowledgeable and well-capitalized (especially in relationship to their principals) are better left to bear full personal liability for business torts on both incentive and risk-bearing grounds. As Shavell (1987, p. 174) argues, apart from the conventional context of delicts committed by the employees of large enterprises, ‘there is no natural presumption’ about the comparative capitalization of principals and agents – or about the ability of principals to observe the loss avoidance behavior of agents. Imposing liability on principals who cannot monitor their agents is unlikely to reduce accident costs and, as Sykes (1984, p. 1249) notes, may actually decrease safety by lowering the expected liability of agents for their own negligence. Finally, most commentators agree that whatever the advantages of vicarious liability in deterring misconduct, it clearly increases costs of administering the tort system by including additional defendants in litigation (Epstein and Sykes, 2001).

Depending on the nature of agent misconduct, vicarious liability may sometimes be inappropriate even in the context of large firms. One example arises when senior managers intentionally release fraudulent information into the capital market to protect their jobs or secure personal benefits. As Arlen and Carney (1992) note, vicarious liability is unlikely to deter top managers, who are otherwise charged with supervising the firm, when these managers are trapped in an end game and take desperate measures to avoid bankruptcy. Further, the risk-bearing rationale for imposing liability on the firm rather than on its agents is weak for such self-conscious misconduct because managers can avoid risk of liability simply by refraining from making misleading statements. Finally, making the firm liable for damages inflicted by its top managers on a subset of its own investors has perverse
consequences. Absent strong evidence that such liability leads managers to monitor one another, its effect is simply to shift assets (net of litigation expenses) from one class of innocent investors to another. In large part for these reasons, ‘[W]hat is most notable [today] is how many scholars from across the ideological spectrum have now joined the doubters of enterprise liability, at least with respect to private securities litigation’ (Langevoort, 2007, at p. 629; see also Coffee, 2006). An open question that remains, however, is that the costs that one firm’s misrepresentations impose on similar market-traded firms might provide an alternative rationale for enterprise liability.

Arlen (1994) also identifies a second circumstance in which holding firms vicariously liable for their agents’ intentional wrongdoing can generate perverse incentives and increase enforcement costs. Where an agent’s misconduct is difficult to detect, her firm is likely to enjoy a considerable advantage over outsiders in monitoring for it. Yet the firm will not monitor optimally under a vicarious liability regime – and may not monitor at all – if the information that the firm acquires by monitoring increases its own probability of incurring vicarious liability. The reason is straightforward: increased monitoring lowers the firm’s expected liability costs by raising its ability to deter or prevent misconduct, but increased monitoring also raises the firm’s expected liability costs by increasing the probability that, should misconduct occur, the firm will be held vicariously liable for it.

Although Arlen (1994) directs her analysis to corporate crimes, the ‘potentially perverse’ effect that she identifies extends to vicarious civil liability for torts that may be difficult to detect without monitoring by the principal. A related observation, made in Arlen and Kraakman (1997, pp. 712–17), is that a separate credibility problem arises where strict vicarious liability is used to induce firms to monitor or investigate misconduct. The crux of the problem is that, absent a commitment device such as reputation, firms may not have an incentive to actually monitor, or to investigate and report, misconduct after it has occurred. While threats to implement these measures would deter misconduct if they were credible, agents may not perceive them as such because of the costs they would impose, if implemented, on the monitoring firms themselves. In this case vicarious liability adds nothing to deterrence except enforcement costs and enhanced liability risks for firms. Put differently, some firms may be unable to make credible enforcement threats because wayward agents rightly suspect that implementing these threats would be acting against their interest. By contrast, an element of duty-based liability such as a negligence rule can assure the credibility of enforcement threats, just as it can overcome the perverse effects associated with traditional vicarious liability (Arlen and Kraakman, 1997, pp. 717–18).
An additional set of problems associated with strict vicarious liability arises in the context of legal entities such as governmental bodies and non-profit corporations or foundations which are not subject to ordinary market constraints. Without knowing the extent to which these institutions are optionally funded in the first instance, it is impossible to tell whether vicarious liability for harms committed by their agents will result in optimal caretaking and self-policing, or in efficient risk-bearing. For example, holding states liable for the actions of their agents or their citizens will result in the politically efficient level of monitoring but not in the socially efficient investment in monitoring (Posner and Sykes, 2007, pp. 87–93). Furthermore, vicarious liability is a poor instrument for regulating the activity levels of principals who function outside of market environments (see Kramer and Sykes, 1987, pp. 278–83). It is simply unclear how cost internalization affects the scale of the non-market enterprise – it might yield too much or too little activity (Kramer and Sykes, 1987, p. 286). For this reason, a duty-based or negligence-based liability regime might be preferred to strict vicarious liability for non-market entities such as cities (Kramer and Sykes, 1987, p. 294) – just as it might sometimes be preferable for rival firms where perverse incentive and credibility problems are severe.

Recent commentators also point to additional limitations on the vicarious liability doctrine as it is traditionally employed. Hamdani (2003) examines strict liability as a method of motivating ‘gatekeepers’, such as underwriters and accountants, to monitor their clients. Like other commentators, Hamdani reminds us that strict liability is efficient only to the extent that gatekeepers can detect wrongdoing by their clients (for analytical purposes, their ‘agents’). In addition, Hamdani underscores the risk of adverse selection in the market for gatekeeping services if gatekeepers cannot distinguish between law-abiding and high-risk clients \textit{ex ante}, and charge for gatekeeping services accordingly. On a different tack, Arlen and MacLeod (2005) critique the traditional distinction between ‘servants’, whom the principal has a legal right to control, and ‘independent contractors’, whom the principal does not control (although they may be ‘agents’ in the legal sense), and therefore for whose misconduct the principal escapes vicarious liability under common law. As Arlen and MacLeod point out, this distinction encourages principals to adjust their organizational structure to minimize liability costs by relying on judgment-proof independent contractors, even if, under a regime of vicarious liability, they could mobilize the monitoring resources to greatly reduce social costs from their agents’ misconduct (ibid. at 139–40).

The principal’s power to evade liability by resorting to independent contractors closely parallels the ability of equity holders in corporations...
or other limited-liability organizational forms to mold the legal structure of enterprises to minimize liability costs. For example, although there are well-established reasons for limiting shareholder liability for a company’s contractual obligations, the case for limiting shareholder liability for the company’s torts is at the very least contestable (see Hansmann and Kraakman, 1991). Among the arguments against limiting shareholder liability for tort costs is that this rule allows entrepreneurs to opt out of compensatory damage rules at will, either by assigning high-risk steps in the manufacturing process to subsidiaries, or by contracting with thinly capitalized but ostensibly independent companies precisely in order to externalize tort costs (ibid. at 1913–15).

Finally, Mattiacci and Parisi (2003) point out that vicarious liability regimes arbitrate between two ‘third parties’ – the principal and the injured party, who might be incentivized to control the costs of agent wrongdoing. The principal is generally the lowest-cost monitor, but the potential injured party may have a cost advantage in implementing precautionary measures. Mattiacci and Parisi (2003) conclude that specifically in an employment relationship between agent and principal – but not necessarily in other agent–principal relationships – efficiency is best served by shifting the costs of accidents to the principal rather than to the injured party.

5.4 The interaction between principal and agent liability
An important question in the literature concerns the relationship between vicarious liability and the legal regime under which the principal’s agent incurs personal liability. Vicarious liability is a form of strict liability: the principal is absolutely liable for the delicts of the agent as if the principal actually were the agent. Put differently, the agent and the principal share exactly the same liability: the principal and the agent both wear the same shoes, legally speaking. Nothing that the principal has done, or might have done, bears on this liability. Yet whether this complete identity of principal and agent liability is appropriate is open to challenge in many circumstances.

Consider first whether the agent and the principal should face the same liability. In the standard case where the principal is an enterprise, the agent is an employee, and the agent’s actions trigger significant liability, a rule of vicarious liability generally makes the enterprise rather than the agent liable as a practical matter (Kraakman, 1984a, 1984b). At most, the culpable agent faces the loss of his job and the risk of losing limited assets in a civil lawsuit. Chapman (1996) argues that this shift from individual to enterprise liability protects firms from the agency problem of overcompliance that might otherwise arise as managers sought to reduce their risk of personal liability.
As Polinsky and Shavell (1993) observe, however, the opposite problem may also arise: the firm may not be able to administer private sanctions severe enough to induce its employees to take optimal care where the social costs of torts are large. Thus, it may be appropriate to not only sanction employees as well as firms, but also to administer different sanctions – for example, criminal sanctions such as fines and imprisonment – to employees, even when the firm remains liable for only civil damages. Polinsky and Shavell (1993) propose criminal liability for employees, then, not because employees are inherently blameworthy, but rather because their limited assets may insulate them from the limited range of contractual sanctions that are at the disposal of the firms who are their principals. Of course, if the firm’s agents become criminally liable, the firm must pay wages to compensate its employees for their greater liability costs and its own vicarious liability should be reduced accordingly. Failure to reduce the firm’s liability in this fashion would distort its activity level and undesirably discourage consumption (Polinsky and Shavell, 1993, p. 241). It should also be noted that non-monetary sanctions such as imprisonment are costly to impose on employees. Thus, an independent rationale for imposing liability on the firm in lieu of its agents is that firms are more likely than their agents to be able to pay monetary fines and are therefore less costly to sanction (Shavell, 1985).

Next, consider whether firms and agents ought to face liability under precisely the same circumstances as they currently do under a traditional regime of vicarious liability. Polinsky and Shavell (1993, pp. 251–3) argue that vicarious liability may often be underinclusive in effect, because firms should be strictly liable for harms associated with their production processes while their employees ought to be liable only under a negligence standard. One argument offered by Polinsky and Shavell (1993) is that a negligence standard offers a stronger incentive for caretaking than strict liability does when agents are partially insulated from liability by limited assets. Other arguments for a negligence standard include its value in economizing on costly criminal sanctions such as imprisonment, and its potential value in limiting the risk-bearing costs of risk-averse corporate agents.

A different issue associated with holding agents and principals liable in precisely the same circumstances arises when principals are vicariously liable for the negligence of agents – as distinct from facing strict liability for the underlying misconduct (as Polinksy and Shavell, 1993, propose). Because negligence standards govern much of tort law, firms are often strictly liable for employee negligence under the traditional vicarious liability regime. But establishing the negligence of corporate employees who act deep within the enterprise may be extremely difficult without the assistance
of the corporate principal itself. As Chu and Qian (1995) point out, this juxtaposition of corporate liability and monitoring leads to a familiar problem: vicarious liability gives the principal a powerful incentive to withhold monitoring evidence from the court precisely because the principal cannot be vicariously liable unless its agent is found negligent in the first instance. This effect parallels Arlen’s (1994) analysis of possible perverse effects associated with vicarious corporate criminal liability insofar as it turns on the difficulty of detecting misconduct (here the agent’s negligence) without enlisting the cooperation of the principal. If, as proposed by Polinsky and Shavell (1993), a corporate principal is strictly liable for its agent’s wrongdoing regardless of whether its agent was negligent, the principal’s incentive to withhold information about its agent’s negligence is clearly mitigated. Yet this incentive will not disappear entirely, as long as monitoring by a corporate principal increases its prospective liability costs (Chu and Qian, 1995, p. 320).

5.5 Negligence and composite vicarious liability regimes

As the preceding discussion indicates, traditional vicarious liability is a relatively rigid regime that, in some circumstances, may fail to satisfy one of the fundamental objectives of tort law: either providing for the internalization of tort costs or motivating optimal monitoring and precautionary measures. In most cases, strict vicarious liability does force firms to internalize tort costs. In fact, when principals cannot monitor their agents’ behavior, the only justification for vicarious liability is the internalization of tort costs and the concomitant regulation of activity levels. It is possible, however, that principals may be in a position to prevent some forms of misconduct that are not usually assigned to the marginal costs of the enterprise. In this case, a negligence rule that imposes liability only when principals fail to take reasonable steps to prevent misconduct may dominate strict vicarious liability, precisely because such a rule does not charge the full cost of misconduct to the firm (Sykes, 1988, pp. 577–9). In the more conventional case where tort costs are appropriately assigned to the enterprise, a chief drawback of traditional strict liability is the perverse monitoring incentive analyzed by Arlen (1994) and Chu and Qian (1995): that is, the risk that principals will not monitor their agents optimally because doing so might increase their risk of incurring vicarious liability. Here too, as was discussed in Section 5.3, a negligence standard that imposes secondary liability only on principals who failed to take reasonable steps to monitor their agents is a natural solution to the risk of inadequate monitoring under a strict liability regime, especially if this negligence regime extended to ‘agent–principal’ relationships beyond those typically reached by respondeat superior.
There are, however, important drawbacks to a regime of ‘negligence-based’ vicarious liability, as it is termed by Kramer and Sykes (1987, p. 283). For example, a negligence standard will not regulate activity levels efficiently by assuring that firms fully internalize the costs of their torts. In addition, a negligence regime is arguably poorly suited to inducing firms to undertake other kinds of measures to prevent misconduct – such as reorganizing production processes – that do not involve monitoring or affect the principal’s risk of incurring liability. Finally, a high level of judicial error in evaluating the negligence of judgment-proof agents will reduce the incentive of the principal to invest in monitoring and controlling the agent (Choi and Bisso, 2007). The latter effect also suggests that the law not interfere with the principal’s discretion to discipline agents under ‘negligence-based’ vicarious liability regimes (ibid. at p. 10).

In the case of intentional torts and crimes, Arlen and Kraakman (1997) discuss three types of ‘mixed’ liability regimes that are designed to induce corporate principals to undertake appropriate monitoring measures (and possibly to report agent misconduct as well), while simultaneously encouraging preventive measures and assuring that firms internalize the full costs of their agents’ misconduct. The first type includes regimes that, through use of immunity or privilege doctrines, attempt to insulate corporate principals from any increase in their probability of prosecution arising from their internal monitoring and investigatory efforts. An example is coupling strict liability for environmental harms with an environmental audit privilege, to ensure that firms retain their incentives to undertake such audits. The second type is a regime of strict liability with a variable sanction that declines to offset any increase in the expected liability that a firm would otherwise incur from monitoring for employee misconduct. Finally, the third type includes ‘composite’ regimes that combine a negligence rule to regulate corporate monitoring and investigation of misconduct with a residual element of strict liability to ensure that corporate principals adopt preventive measures and internalize the costs of agent misconduct. Here an example is the liability regime created by the US Federal Sentencing Guidelines for corporate crimes (see Arlen and Kraakman, 1997, pp. 745–52).

Arlen and Kraakman (1997) argue that the range of mixed vicarious liability regimes – extending from evidentiary privileges through adjusted sanction regimes to composite regimes – are increasingly costly to administer effectively but are also increasingly likely to satisfy the multiple enforcement objectives of a vicarious liability regime. To be sure, some commentators oppose any resort to a negligence standard to supplement strict liability (as is necessary in a composite regime) on the grounds that judicial error in administering the standard will inevitably create liability
in excess of the social cost of misconduct (Fischel and Sykes, 1996, pp. 328–9). This effect, however, can be ameliorated by downwardly adjusting the composite liability regime’s residual liability level.

It follows that the traditional American rule of strict vicarious liability is well-suited to the ordinary case of wrongdoing in which the costs of agent misconduct are appropriately charged to the principal, and misconduct is unlikely to escape detection. Whenever one of these conditions fails, however, strict vicarious liability may be dominated by either negligence-based vicarious liability or a mixed regime that includes elements of both strict and negligence-based liability.

### 5.6 Reaching beyond the principal: alternative liability targets

Traditional vicarious liability makes the legal ‘principal’ liable for her agent’s torts. But other actors besides the principal may also be in a position to monitor safety precautions or thwart third-party misconduct: for example, senior managers within the firm who supervise lower-level employees; or the lawyers, accountants and underwriters who facilitate fraudulent public issues of securities. In fact, secondary liability (if not necessarily traditional strict vicarious liability) for the torts and delicts of primary wrongdoers is a common legal control strategy well outside the domain of principal–agent relationships.

In some cases, the secondary liability of parties other than the organizational principal or enterprise serves as a backstop for traditional vicarious liability. For example, Kraakman (1984a, 1984b) argues that the personal liability of corporate managers for garden-variety torts protects against the possible inadequacy of corporate assets to satisfy the firm’s liability. Thus, in a reversal of the traditional justification for vicarious liability discussed above in Section 5.1, Kraakman (1984a, pp. 869–71, 1984b) suggests that most personal liability of managers for corporate torts should be understood as protecting tort victims against undercapitalized firms rather than agents, since well-capitalized firms invariably insulate their managers from liability through insurance or indemnification contracts.

In some cases, however, the law blocks the indemnification of managers for their own misconduct or extends liability for corporate misconduct to a broader circle of influential actors beyond the group of top managers, such as outside directors and accountants associated with companies. Kraakman (1984a, 1984b) describes this as a ‘gatekeeper strategy’ that is designed to augment potentially inadequate levels of liability imposed on the firm itself. Thus, just as vicarious corporate liability can enhance legal controls over judgment-proof agents, so in extreme cases the personal liability of corporate managers, directors, and even outside directors can partially offset the inadequacy of corporate liability.
In addition, the potential uses of secondary liability, whether civil or criminal, and the value of the gatekeeper strategy, extend well beyond the corporate enterprise. An important research agenda turns on identifying contexts where these liability strategies are or are not cost effective. Kraakman (1986) examines several considerations bearing on the costs and benefits of imposing secondary liability on a contracting party in order to deter or prevent the misconduct of the counter-party to the contractual relationship. The chief enforcement tool at the disposal of a private ‘gatekeeper’ is the power to withhold goods, services, or facilitation from a counter-party engaged in risky or suspect behavior, just as the principal’s chief incentive device in the traditional agency relationship is the threat to fire an agent who engages in risky behavior. Moreover, whether gatekeeper liability is likely to prevent misconduct depends in part on the same considerations that contribute to an effective regime of vicarious liability, such as the assets and the expertise of the gatekeeper relative to those of the potential tortfeasor. But especially in the case of intentional misconduct, the efficacy of gatekeeping turns in large part on how easily would-be wrongdoers can contract around honest gatekeepers who withhold their services from suspect endeavors (Kraakman, 1986, pp. 66–74).


5.7 Corporate civil liability versus criminal liability
The vicarious liability regime that accounts for most corporate liability in the United States makes no distinction between civil and criminal liability. It is well-accepted that when corporate agents commit crimes within the scope of their employment, firms can be criminally prosecuted on a theory of vicarious liability – just as firms are vicariously liable for the civil torts of their agents. Recent literature on vicarious liability, however, questions the value of imposing specifically criminal liability on corporate principals, as distinct from imposing vicarious civil liability for the criminal acts of corporate agents.

The critique of corporate criminal liability proceeds on several fronts. Fischel and Sykes (1996, pp. 322–4) point out that the specifically criminal
sanction of incarceration is unavailable against corporations, and that the
criminal law objective of incapacitating criminals though incarceration
makes little sense in the context of corporate liability. Equally important,
Fischel and Sykes (1996) argue, criminal sanctions are uncalibrated to the
level of harm associated with crime, which may be appropriate to penalties
imposed on individuals but is inappropriate to penalties operating on the
corporate level.

Criminal penalties imposed on individuals for intentional crimes such
as murder create little risk of overdeterrence: less murder is always better.
But penalties imposed on the corporate level lack this character, precisely
because they are corporate penalties. Corporations are, in Fischel and
Sykes’s (1996, p. 323) phrase, ‘webs of contractual relationships consist-
ing of individuals who band together for their mutual economic benefit.’
Corporate crimes typically involve actions committed by some corporate
agents without the knowledge and approval of others. It follows that
the primary function of penalties imposed on the corporate level is not
to deter in the conventional sense but to induce firms to monitor their
agents and prevent crimes: that is, the classic justification for vicarious
liability (see Fischel and Sykes, 1996, p. 324; Parker, 1996). The base-
line penalty imposed on the corporation, then, should be civil liability
equal to the social cost of crime discounted to reflect its probability of
detection.

At least in the United States, there is little reason to believe that civil
penalties systematically underdeter corporate offenders (at least in the area
of defective products) except when these offenders are judgment proof,
in which case additional criminal fines imposed at the corporate level
are unlikely to increase marginal deterrence (Wheeler, 1984). But where
corporate defendants are already solvent and adequately subject to civil
liability, additional criminal liability is likely to lead to the various costs of
overdeterrence, such as costly products arising from excessive design and
manufacturing precautions. Then, too, there are the additional administra-
tive costs that arise from private and public legal actions, particularly when
multiple public authorities have standing to bring suit regarding the same
incident or possible delict (ibid.). One might argue that the large potential
damage awards at stake in civil actions justify replacing civil liability with
the more rigorous and defendant-friendly procedures of criminal law.
Conversely, however, one might counter that since criminal convictions
are hard to obtain, a criminal law regime requires even larger fines than
damage awards under a civil regime to deter tort-like wrongdoing such as
the manufacture of defective products, and that larger fines will further
aggravate the underdeterrence problem presented by undercapitalized
corporations.
A second critique of corporate criminal liability does not question penalty levels *per se* but asks: why prefer criminal penalties over equivalently scaled civil liability? The feature that arguably distinguishes criminal sanctions on the corporate level – social stigma and reputational loss – render these penalties less predictable and more costly than parallel civil penalties (see Karpoff and Lott, 1993; Khanna, 1996, pp. 1501–12). Moreover, in most cases, the administration costs of criminal prosecution are likely to be larger than the costs of civil lawsuits by government agencies (Khanna, 1996, pp. 1512–31).

In light of these multiple critiques of corporate criminal liability, the justification for vicarious criminal liability for corporate principals – or principals more generally – remains an important topic for future research. If no plausible justification can be found, the implications for law reform are clear: vicarious corporate liability should be decriminalized.

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