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Penance But No Absolution

The Paradox of Corporate Criminal Liability

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The legal fiction of corporate criminal liability may finally get the rewrite it badly needs. Urged by practitioners and academics for decades, arguments for changing corporate criminal liability, if not abolishing it altogether, may now have a receptive audience in Washington.

Recent concerns about the overreaching of prosecutors who extract corporate privilege waivers and pressure companies to cut off employees' legal fees — issues that surfaced prominently in the KPMG case — led to Senate Judiciary Committee hearings and proposed legislation by Senator Arlen Specter (R-PA) that would prohibit the government from demanding, or "conditioning treatment" on, corporate privilege waivers, or conditioning a civil or criminal corporate charging decision on whether a company ad-vances legal fees to its employees. Perhaps to preempt Senator Specter's proposal, on Dec. 12, 2006, the Department of Justice (DOJ) issued a memorandum from Deputy Attorney General Paul McNulty revising the Thompson Memorandum. The pertinent changes include requiring re-quests for corporate privilege waivers to be approved by senior DOJ officials, and instructing prosecutors that they are not to consider whether a company is advancing fees in charging decisions unless advancement is intended to "impede" a criminal investigation.

These changes are a step in the right direction, but the Judiciary Committee testimony regarding the Thompson Memorandum's effect on the right to counsel in corporate investigations highlighted problems that cannot be resolved simply by revising the Memorandum's privilege waiver and fee-advancement provisions. Instead, the current standard determining when a corporation has committed a crime must itself be revised. As the Committee on Capital Markets Regulation—known as the "Paulson Committee" because Treasury Secretary Henry Paulson is expected to endorse its conclusions—noted in its November 30, 2006 report, with rare exceptions, "there is no independent benefit to be gained from indicting what is in fact an artificial entity" because of the harm an indictment causes innocent employees and shareholders. *See* Paulson Committee's Interim Report at 84-85, www.prismpublicaffairs.com/Committee_Interim_Report.pdf.

The Best Path to Reform

Accordingly, because the policymakers might actually be listening, now may be the time to raise anew the criticisms of corporate criminal liability, and the best path to reform may simply be to employ more consistently the fiction that led to the standard in the first place, *i.e.*, that a corporation's acts and thoughts are those of its agents. Why not impute to corporations not just an individual agent's bad acts, but the good acts of other corporate agents as well?

Under the current standard, a corporation can be held criminally liable for the acts of any of its employees — no matter how menial — taken within the scope of their employment for the benefit of the corporation. *New York Central & Hudson River Railroad Co. v. U.S.*, 212 U.S. 481, 494-495 (1909). The Supreme Court borrowed this standard from tort law based on the theory that, because a corporation "can only act through its agents and officers," a corporation should be deemed to have the knowledge and purposes of those agents. In subsequent cases, courts construed this vicarious liability standard to allow a single low-level employee's criminal acts to be imputed to a corporation even when those acts were contrary to corporate policy or express instructions. *See, e.g., U.S. v. Twentieth Century Fox Film Corp.*, 882 F.2d 656, 660 (2d Cir. 1989) (extensive effort to ensure compliance with the law does not immunize a corporation from liability for employee's action within the scope of her authority); *U.S. v. Hilton Hotels Corp.*, 467 F.2d 1000 (9th Cir. 1972) (corporation criminally liable for single employee's actions contrary to corporate policy and the explicit direction of his manager).

But the theory that a corporation's acts and purposes are those of its agents does not mean that the only relevant acts and purposes are bad ones; if bad acts and purposes of employees are imputed to a corporation, it seems good acts should be as well. That is, in applying the legal fiction of corporate liability, there is no logical reason not to consider the intentions of *all* relevant corporate actors in assessing what the corporation's intentions were, especially in light of the fact that all corporate actors, innocent and guilty alike (not to mention innocent shareholders), will suffer the consequences of a corporate conviction. In fact, by focusing solely on the wrongful acts of isolated employees and refusing to consider the intentions and actions of all corporate agents, the current standard imposes liability for wrongdoing that is not "corporate" at all.

THE 'COLLECTIVE KNOWLEDGE' DOCTRINE

The current standard's artificiality and constrained nature become especially evident in cases applying the "collective knowledge" doctrine, which provides that, in determining whether a corporation had the requisite *mens rea* to commit a crime, the company's knowledge is deemed to be the aggregate knowledge of all of its employees. *See*, *e.g.*, *U.S. v. Bank of New England*, 821 F.2d 844 (1st Cir. 1987). The government does not have to demonstrate that any single employee knowingly violated the law. Instead, it must prove merely that the sum of what various employees knew satisfies the knowledge element of the charged violation. As *Bank of New England* put it, the acts of a corporation "are, after all, simply the acts of *all* of its employees operating within the scope of their employment," and thus a corporation knows everything that its various departments know. But if a corporation's mental state and actions in fact consist of the intentions and actions of all of its employees, then efforts by employees to comply with the law — for example, maintaining effective compliance programs — also should figure in the corporate *mens rea* determination.

AUTOMATIC LIABILITY

The law's refusal to develop a corporate criminal liability standard that takes into account corporate compliance efforts appears driven by the belief that strict vicarious liability is the best way to ensure that corporations implement rigorous policies to prevent and detect wrongdoing. Corporations will have even more incentive to police themselves, however, if those efforts enable them to avoid criminal liability altogether. Certainly, they will have more incentive than they have now, when compliance and enforcement efforts, at most, allow a corporation to argue to a prosecutor, who has absolute discretion in the matter, that application of the relevant Thompson (now McNulty) Memorandum factors warrants that it not be charged. Those factors direct prosecutors, in deciding whether to charge a corporation, to consider, among other things, the existence and adequacy of a company's compliance program, the pervasiveness of wrongdoing within the company, and the company's remedial actions. (The Memorandum adds that "it may not be appropriate to impose liability upon a corporation, particularly one with a compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee.") Even if a corporation's preventative and remedial measures persuade a prosecutor not to indict, however, the company nevertheless may be forced to enter into a deferred-prosecution agreement that requires it to take a range of actions from firing employees who exercise their constitutional right not to speak with the government, to installing a prosecutor-picked monitor in the boardroom.

Prosecutors have the leverage to force corporations to accept such ultimatums because, under the current standard, a corporation's efforts to prevent wrongdoing do not absolve it from liability. Thus, corporations are automatically liable for their employees' misdeeds. Automatic liability means that a corporate indictment is essentially a corporate conviction. Accordingly, corporations will do whatever they can to avoid indictment, including acceding to demands to let prosecutors direct corporate policy. Prosecutors have come to expect no less from a corporation that wants to appear cooperative. As one of the primary drafters of the Thompson Memorandum recently explained, when an employee is suspected of wrongdoing, prosecutors expect a corporation to give them "discretion as to what actions the company takes, such as whether the company should conduct its own investigation, what steps it should take to protect the prosecutor's investigation, and how to place individual wrongdoers in a status most conducive to similar cooperation." A. Hruska, *What's Really Going On in Corporate Charging Decisions?,* N.Y.L.J., Nov. 10, 2005, at 4.

ENJOYING THE LEVERAGE

Prosecutors no doubt enjoy the leverage they have over corporations. One prosecutor has used such leverage to obtain an endowed professorship for his former law school, and another jobs for his state, from "cooperative" corporations desperate to avoid indictment. *See* J. Coffee, *Deferred Prosecution: Has it Gone Too Far?*, Nat'l L. J., July 25, 2002. As a result, the DOJ likely will not lead the effort to reform the criminal liability standard, notwithstanding the fact that the McNulty Memorandum acknowledges the inadequacy of strict vicarious liability. Adopting a corporate criminal liability standard that recognizes a corporation's compliance efforts would eliminate the possibility of prosecutorial abuse enabled by the existing standard, such as the gun-barrel corporate governance exemplified by government-installed monitors.

Possibilities for reforming the standard include making corporate criminal liability turn on whether wrongdoing was pervasive within a company and whether it was condoned or facilitated by senior management or the board of directors. Another possible reform might create, by analogy to the "collective knowledge" doctrine now used to expand corporate criminal liability, a doctrine of "collective intent" that would determine a corporation's intent by considering the intent of all pertinent corporate agents and policy makers. In addition, corporations could be allowed to assert an affirmative defense of good faith based on evidence of their efforts to prevent malfeasance. Whatever the mechanism, corporations that take all reasonable steps to prevent and punish criminal behavior should have a legal defense to criminal liability rather than have their only chance for justice depend on the whims of federal prosecutors.

CONCLUSION

After 100 years, the law is not likely to give up the fiction that a corporation can commit a crime through the actions of its agents. Accordingly, the most promising prospect for reform may be not to try to abolish that fiction, but to make it better reflect actual corporate intent and conduct.

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