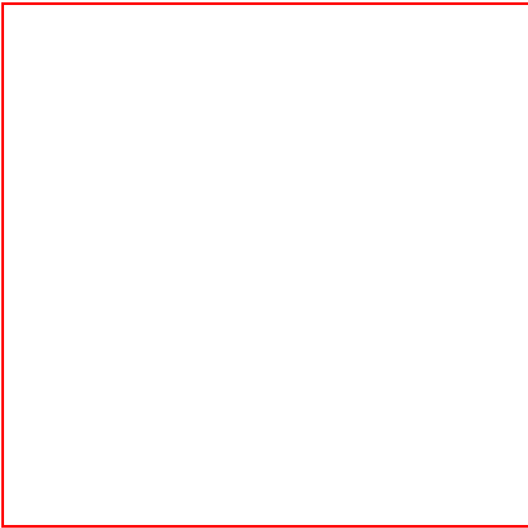

Corporate Criminal Liability in the United States:

Has Reform in the Law Brought Reform in the Boardroom?

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In the "white collar" or business crime arena, the investigation and prosecution of corporations is a high priority of federal law enforcement. The U.S. Department of Justice has pursued high-profile enforcement efforts aimed at corporate criminal conduct in a variety of areas, including health care, antitrust, defense contracting, environmental crime, and securities enforcement. Government officials have demonstrated their willingness to prosecute corporate entities and, given their recent achievements, there is every reason to believe that such prosecutorial efforts will continue.

As legal entities that act through agents and employees, corporations are held vicariously liable for the criminal acts of agents and employees in a disturbingly broad range of circumstances. Even the most fastidious and diligent corporate citizen may find itself facing investigation, prosecution, or conviction. The consequences of such corporate prosecutions can be devastating, as evidenced recently by the Archer-Daniels-Midland Company's October 1996 agreement to pay a record $100 million fine for criminal antitrust violations. In the health care arena, Caremark, Inc. pleaded guilty in June 1995 to a series of violations involving the Medicare and Medicaid programs and paid a $160 million settlement, including fines, damages, and restitution. These "titanic" examples represent only the tip of the iceberg. In the past two years, the Department of Justice's antitrust division has obtained nearly $440 million in fines in international cartel prosecutions. Such vigorous criminal enforcement is likely to continue.

The U.S. Sentencing Guidelines for Organizations ("the Guidelines") authorize courts to impose hefty fines, as high as $290 million, depending upon the culpability of the corporate conduct. The small business is not immune—over 90% of the companies sentenced under the Guidelines since 1991 have been privately held or controlled by only a small group of shareholders. Even where there is no finding of liability, the adverse publicity and litigation costs attendant to a large-scale government investigation

and subsequent prosecution can be ruinous. Accordingly, no business large or small can afford to ignore the looming threat of criminal sanction and the broad reach of the Guidelines.

While the Guidelines set up a strict framework of corporate criminal liability, they also provide a mechanism through which corporations may lessen the harsh consequences of criminal vicarious liability. Effective corporate compliance programs established by corporate management and counsel can detect potential trouble spots, remedy nascent violations before they give rise to criminal liability, and, where crimes have been committed, mitigate the consequences. This article provides a brief primer on principles of corporate criminal liability, the Guidelines, and the elements of an effective compliance program. Although a compliance program is not an absolute defense against criminal liability, an effective program deters illegal actions by employees and detects misconduct early so that it can be remedied. A program's existence may be a significant factor in the Government's decision to charge the corporation and will have a real impact on the penalty to be imposed at sentencing.

Corporate Vicarious Liability

At common law, corporations could not be held criminally liable. Because the corporate person was a mere legal fiction the corporation could not form the requisite criminal intent, or mens rea, to be adjudged guilty. In 1909, the U.S. Supreme Court abolished this "old and exploded doctrine" in New York Cent. & Hudson River R.R. Co. v. United States, 212 U.S. 481, 496 (1909) holding that the criminal acts of a corporate agent could be imputed to the corporation under standard principles of respondeat superior. In as clear a statement as has been advanced in support of corporate criminal liability, the Court reasoned that: "We see no valid objection in law, and every reason in public policy, why the corporation, which profits by the transaction, and can only act through its agents and officers, shall be held punishable by fine because of the knowledge and intent of its agents to whom it has intrusted authority to act . . . and whose knowledge and purposes may well be attributed to the corporation. . . ." Id. at 495. Henceforth, corporations could be held liable under federal law for the crimes of their employees provided that: the employee was acting within the scope of his or her authority; and the employee acted with an intent, at least partially, to benefit the corporation. See Standard Oil Co. of Tex. v. United States, 307 F.2d 120, 127-28 (5th Cir. 1962); Joseph S. Hall, Corporate Criminal Liability, 35 Am. Crim. L. Rev. 549, 553-55 (1998).

Both of these elements have been interpreted quite broadly. With respect to the first, an employee is not deemed to be acting beyond the scope of his or her authority simply because the corporation does not consider criminal conduct to be part of the job description. Indeed, a corporation may be held liable for an employee's actions that are taken contrary to express corporate policy or instructions. Even low-level employees may subject the corporation to liability provided their conduct is directly related to duties which they are authorized to perform. For example, a medical company's billing clerk who falsely bills unperformed services to Medicare or a maintenance employee who dumps hazardous chemicals behind the company plant both may subject their employers to criminal penalties despite corporate

condemnation of such conduct.

With respect to the second, as one court has held, if an employee performs an act "with a view of furthering the master's business, of doing something for the master, then the expectation or hope of a benefit, whether direct or indirect, makes the act that of the principal," Hudson, 212 U.S. at 492, and thus subjects the employer to criminal liability. Taking the example of the billing clerk posited above, if the employee subjectively believed he or she was benefitting the company by falsely billing services, that intent is imputed to the corporation. Again, the fact that the corporation would not consider such false billing, or other similar crime, to be a benefit has been held by most courts to be legally irrelevant. After-the-fact claims that the corporation sharply would have disavowed such conduct had management known it was occurring are generally not credible to prosecutors. Closing the barn door after the horses have escaped will not fend off an investigation and possible prosecution. Courts have even extended the scope of authority doctrine to include "apparent authority," that is, the authority a reasonable outsider would expect the employee to have under the circumstances.

Equally troubling from the corporate view is the collective knowledge doctrine under which the acts of several employees may be aggregated so as to subject a company to criminal liability although none of the acts, taken individually, would be sufficient alone to constitute a crime. Using the above example, if the billing clerk simply negligently recorded and submitted incorrect billing information without verifying its accuracy, he or she probably would not have committed a crime for which he or she, or his or her employer, may be held liable. If a supervisor subsequently discovered the false information and failed to take remedial action, however, the collective knowledge of the two employees might be sufficient to violate the criminal false claims act. Under this doctrine, the individual employees may be acquitted while the corporation, which is only vicariously liable for its employees' acts, may be convicted!

These imputed intent and collective knowledge doctrines operate in tandem to expose corporations to potentially devastating sanctions for conduct over which corporate directors and officers may have had little or no actual knowledge or control. As one proceeds higher up the ladder of corporate management, it becomes less and less likely that the officers and directors will be aware of the potentially criminal acts of low-level employees. This absence of knowledge or control, however, is not a defense to corporate liability. Despite the apparent injustice of virtually strict corporate criminal liability for the acts of rogue employees, courts show no sign of limiting these doctrines. Responsible federal law enforcement officials have expressed the view, however, that the imputation doctrine is viewed through the prism of corporate responsibility - whether and to what extent senior management and the directors took steps to prevent and detect misconduct.

Current Developments

Within the basic framework of corporate criminal liability, there have been several recent developments involving the duty of care to be exercised by directors of a corporation.

Although internal compliance and due diligence programs will not immunize a corporation from liability, they can be mitigating factors when a court determines a criminal penalty. In recent years, it has become clear that corporate compliance programs are critically important for another reason -- protecting the corporation's directors from liability. The directors of a corporation, unlike the corporation itself, will not usually be held criminally responsible for the illegal actions of their employees. However, two recent cases have indicated that directors are not totally immune from the consequences of employees' actions. In the Caremark, Inc. case, the Delaware Court of Chancery addressed the issue of personal liability of corporate directors for the misconduct of corporate employees. In 1994, Caremark Inc. was charged with multiple felonies and after a multi-year investigation, entered a plea agreement with the United States admitting to some charges in the indictment and committing itself to pay over $250 million to various parties. At the same time, a derivative action was filed against the directors of Caremark which claimed that they breached their fiduciary duties by failing to prevent this criminal conduct and the ensuing penalties. It was not disputed that the directors were unaware of the criminal conduct until notified by the investigative agents. The Chancery Court reviewed a proposed settlement of the derivative action.

In order to determine if the settlement was a reasonable one, the court in Caremark analyzed the plaintiff's theories of liability. In so doing, the court recognized that, under Delaware law, directors are not required to "operate a corporate system of espionage" to uncover employee wrongdoing they have no reason to suspect. However, boards must "assur[e] themselves that information and reporting systems exist in the organization" to inform them of issues requiring their attention. The court reasoned that "a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists. . ." If the system ultimately fails, the court could then conclude that the directors fulfilled their duty of care and should not be held personally liable.

Although Caremark concerned directors' potential civil liability for the corporation's criminal behavior, it has been held that directors who are on notice of questionable conduct and fail to take timely action may find themselves criminally liable for the conduct of officers and employees. In In re W.R. Grace & Co., the Securities and Exchange Commission investigated the company's failure to report the full retirement package that W.R. Grace & Co. offered to its outgoing CEO. Grace's statement about the severance package was based on a standard questionnaire completed by the CEO. In a holding consistent with Caremark, the SEC noted that directors could rely on this internal reporting and disclosure scheme if it were reasonable to do so. However, the directors were personally involved in negotiating this severance package and therefore knew it was under reported by the questionnaire, making it unreasonable for them to rely on it. Although the Commission took no action because of extenuating circumstances, it noted that, when directors unreasonably rely on internal reporting mechanisms, the Commission would seek to have directors held criminally liable when those mechanisms fail.

Another recent trend in corporate criminal liability is the increasing use of parallel civil and criminal

penalties for corporate misconduct. This is largely a product of the Supreme Court's 1997 decision in Hudson v. United States. Under the Constitution's Double Jeopardy Clause, persons cannot be subjected to criminal punishment twice for a single offense. Some civil penalties can be so punitive in nature that the court will interpret them as being transformed into criminal penalties, and therefore subject to the double jeopardy clause. In Hudson the Court affirmed the Ward test making it very difficult to construe civil penalties as "punishment" under the Double Jeopardy Clause.

Unless Congress specifically designated a given sanction as punitive, "only the clearest proof" would compel courts to regard them as such. Shortly after this decision, Attorney General Reno circulated a memorandum throughout the Justice Department encouraging the increased use of parallel civil and criminal investigations and penalties for corporate misconduct.

The Organizational Sentencing Guidelines

Corporations feel the bite of vicarious corporate liability under the Guidelines. Fines are calculated pursuant to a strict mathematical formula that does not leave much to the sentencing judge's discretion. By way of background, the Guidelines were mandated by the Sentencing Reform Act of 1984 in order to promote greater uniformity in sentences meted out by judges with varying philosophies on punishment. Individuals are sentenced according to a fixed grid with a vertical axis comprising 43 offense levels, which are calculated by assigning numerical values to certain specific offense characteristics, and a horizontal axis comprising six criminal history categories. Placing an individual within a particular offense level and criminal history category yields a range, expressed in months, within which a judge may impose sentence, unless there are extraordinary circumstances warranting an upward or downward departure.

Corporations convicted of most "white collar" crimes are subject to Chapter Eight of the Guidelines, Sentencing of Organizations, which was adopted in 1991. Chapter Eight currently excludes environmental crimes, which the Sentencing Commission has proposed should be covered by a separate Guidelines chapter which has not yet been adopted. Under Chapter Eight, a corporation's punishment is calculated by assigning a base fine which is the greatest of: an amount corresponding to the number of offense levels for a given offense taken from Chapter Two of the Guidelines and assigned a monetary value according to a table; the pecuniary gain to the corporation from the offense; or the pecuniary loss from the offense caused by the organization, to the extent the loss was caused intentionally, knowingly, or recklessly. USSG § 8C2.4. That base fine is then subject to a culpability multiplier that is calculated according to a culpability score. In turn, this score varies according to several aggravating and mitigating factors, including: the size of the organization; the involvement or tolerance, either active or tacit, of high-level personnel in the offense and the pervasiveness of that involvement or tolerance; the company's prior criminal history; whether the offense involved a violation of a court order or obstruction of justice; and, most importantly for present purposes, whether the corporation had in place an effective

program to prevent and detect violations of law and whether the corporation voluntarily reported the offense and actively cooperated with the authorities. USSG § 8C2.5. The sentence generally is the product of the base fine and the culpability multiplier, which yields a range in which the judge may impose a fine, unless extraordinary circumstances warrant an upward or downward departure. USSG § 8C2.6-8C2.7.

An uncomplicated hypothetical will demonstrate how the Guidelines operate. Suppose that the billing clerk posited earlier works for a medical center. Further suppose that the clerk had falsely billed $75,000 to Medicare for services not properly payable. Under the Guidelines, the base fine would be the greater of $75,000 (the gain to the corporation or the loss to Medicare) or the value taken from the offense level fine table (here, that value would be $85,000 supposing that the Chapter Two fraud guideline was used and that there was more-than-minimal planning involved in the offense). That $85,000 figure then would be subject to a culpability multiplier of one at the low end and two at the high end, yielding a fine range between $85,000 and $170,000, assuming that there was no involvement or tolerance by high-level personnel, past corporate criminal history, or other aggravating factors. This figure also assumes: the absence of a compliance program; no acceptance of responsibility (i.e., a guilty plea); and no self-reporting. If an aggravating factor is added, the fine range climbs considerably. For example, if the medical center employs approximately 1,000 people, and a director participated in, condoned, or was willfully ignorant of the billing clerk's activities, the fine ranges between $153,000 and $306,000.

There are a number of mitigating factors that can decrease the fine range but all require proactive efforts by corporate management and counsel to be effective. If the company had in place an effective compliance program and self-reported the false billing to the Government reasonably promptly after its discovery, the fine range would be decreased substantially to between $4,250 and $17,000. Thus a corporate compliance program has a palpable mitigating effect under the Guidelines.

Of course, the above hypothetical is far more simple than a large commercial enterprise would likely encounter. Seasoned criminal counsel experienced at negotiating the complexities of Guidelines practice are an absolute necessity whenever the specter of a regulatory investigation and a federal prosecution arises. As discussed earlier, judicial discretion under the Guidelines is strictly circumscribed; therefore, prosecutors have a great degree of control over Guideline outcomes by choosing which offenses to charge and what loss amounts to allege. From the corporation's point of view, once formal charges have been brought the die is cast. Negotiations in a pre-indictment setting enable counsel either to eliminate or at least minimize potential exposure, both in terms of charging and sentencing, by demonstrating that the corporation has made its best effort to prevent criminal conduct. A corporate compliance program often is the centerpiece of an effective presentation by corporate counsel to prosecutors.

Accordingly, negotiations with prosecutors generally are front-loaded, focus extensively on the Guidelines, and quickly turn to a discussion of the diligence of corporate management and counsel in pursuing corporate compliance. Some prosecutors, such as the Antitrust Division of the U.S. Department of Justice, have gone on record indicating that the presence of a corporate compliance program is not a

significant mitigating factor involved in their charging decision. Other prosecutors, however, including many U.S. attorneys, who prosecute the vast majority of business crimes, have signaled that the presence of an effective compliance program is a factor that they will consider in deciding whether to prosecute. In the closely-related civil fraud arena, the Civil Division of the Department of Justice, which evaluates each qui tam whistle blower action filed under the False Claims Act to determine whether the government should intervene, views the presence or absence of a compliance program as critical to its decision. In addition, at least two courts of appeals have indicated that a corporate defendant may present evidence of an effective compliance program to the jury in order to argue that the actions of a rogue employee were not done to benefit the corporation and thus should not be imputed to the company. Finally, prosecutors deem the compliance program to be an essential ingredient of every corporate plea agreement. For good reason, therefore, the compliance program is fast becoming the rule rather than the exception in the corporate environment.

The Compliance Program

The corporate compliance program is itself a creature of the Guidelines. Under USSG § 8C2.5(f), corporations that have an "effective plan to prevent and detect violations of law" are entitled to a three-point reduction in their culpability score, which, in turn, can have significant benefits as outlined above. To qualify, a program must have been reasonably designed, implemented, and enforced so that it will generally be effective in preventing and detecting criminal conduct. According to the Sentencing Commission's commentary to Chapter Eight, the failure to prevent a particular crime from occurring does not mean that the compliance program was not effective. Rather, the hallmark of an effective program is that the organization exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents.

The Guidelines set forth seven requirements that must be met in order for a compliance plan to qualify as effective:

1. Reasonable Compliance Standards and Procedures

The organization must have established standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of illegal conduct. An aspirational, broad code of ethics that urges compliance will not pass for an effective program under the Guidelines and will not impress prosecutors. An organization must instead implement particular standards related specifically to those areas of a company's business in which there is the greatest risk of conduct which could lead to violations of applicable statutes and regulations.

2. Appointment of a Corporate Compliance Officer

At least one individual must be designated responsible for overseeing corporate compliance with the established standards and procedures. This individual must be deemed high level personnel, whom the Guidelines define as individuals who have substantial control over the organization or who have a substantial role in policy making, including directors, executive officers, and individuals in charge of a major functional unit of the organization.

3. Exercise of Due Care in the Delegation of Discretionary Authority

The organization must use due care not to delegate substantial discretionary authority to individuals whom the organization knew or should have known, through the exercise of due diligence, have a propensity to engage in illegal activities. Corporations involved in government contracts should take particular care to scrutinize the various agency debarment and exclusion lists to ensure that an employee has not previously been subject to prosecution for government contracting fraud. Corporate management and counsel also must be aware that not only must due diligence be performed with respect to the hiring of high-level personnel but also independent contractors, business consultants, and agents must be scrutinized. Depending upon the context, the acts of such independent contractors may subject the company to criminal liability (for example, a foreign agent making payments to government officials in violation of the Foreign Corrupt Practices Act without the parent company's knowledge).

4. Employee Education and Compliance Training

The organization must take steps to communicate its compliance standards and procedures to all employees through training programs, internal publications, and circulated materials. Training is one of the most essential elements of an effective compliance program. Such programs must be regularly repeated and updated so as to ensure that the training remains current.

5. On-going Monitoring and Reporting Systems

The organization must utilize monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents. Organizations must also implement and publicize a system through which employees confidentially can report suspected wrongdoing without fear of retribution (such as an employee hotline).

6. Consistent and Continuous Enforcement of Compliance Standards

The standards must be consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, the disciplining of individuals responsible for the failure to detect an offense.

7. Response to Offenses and Prevention of Reoccurrences

An organization must take all reasonable steps to respond appropriately once an offense has been detected, including any necessary modifications to its existing compliance program. Responding appropriately usually will mean disclosure to government officials.

Paper tiger compliance programs will neither be effective in preventing criminal conduct from occurring nor be of assistance in advocating against prosecution or mitigating the sentence once a crime has been committed. It would be preferable not to establish a compliance program at all than to make an inadequate effort because a clearly deficient program may raise a red flag for prosecutors that the company is attempting to gloss over serious shortcomings that require further investigation. A failure to incorporate or follow any applicable government regulations or requirements; a commission of an offense by high level personnel or a corporate compliance officer; or an unreasonable delay by the organization in reporting a known offense to the authorities all may negate the plan's effectiveness.

Designing, maintaining, and enforcing a corporate compliance program is not without cost. Of course, corporate compliance programs entail business expense and may involve hiring new employees to oversee compliance and corporate restructuring. In addition, some commentators argue that the requirement of prompt disclosure to the authorities of any suspected violations is self-defeating as it results in a greater number of prosecutions and imposition of fines than would occur in the absence of a compliance program. Self-reporting does indeed carry risks; however, the existence of a vigorous compliance program is a corporation's best shot at convincing a prosecutor, a judge, or a jury that it

should not be held accountable for the crimes of a rogue employee. Without demonstrable efforts at corporate compliance, such arguments carry little weight and "too little, too late" will be the likely response.

When corporate management and counsel decide to embark on a compliance program, they should consult with outside counsel possessing broad experience in designing compliance programs and knowledge of the most effective methods for detecting wrongdoing and convincing government officials, judges, and juries that the corporation acted with due diligence to stay within legal bounds. Corporate compliance programs are not one size fits all but must be individualized to suit the needs of each operation.

Again, experienced counsel can fashion an overall compliance program that addresses each area in which a corporation, large or small, is likely to encounter compliance problems, including antitrust, health care, defense contracting, environmental liability, the Foreign Corrupt Practices Act, and securities enforcement. To reemphasize, a half-hearted attempt at compliance is more likely to do a company more harm than good. Efforts must be taken to fashion an appropriate program, including internal investigations properly conducted to ensure maintenance of the attorney-client and work product privileges. Do not wait until you are sitting across from a prosecutor who asks what efforts your company has taken towards achieving compliance. At that point, you may truly have done too little, too late.

Addendum

Applicable Federal Criminal Statutes

A. Conspiracy Statutes. (Companies can be found guilty of conspiring with their own employees, U.S. v. Hartley, 678 F.2d 961 (11th Cir. 1982)).

1. Conspiracy to File False Claims, 18 U.S.C. §286.

2. Conspiracy to Defraud the United States, 18 U.S.C. §371.

3. Conspiracy to Commit an Offense Against the United States, 18 U.S.C. §371.

B. False Statements to Federal Agencies.

1. False Statements, 18 U.S.C. §1001. (Includes concealment of material facts as well as out and out falsehoods.)

2. Possession of False Papers, 18 U.S.C. § 1002. (Requires intent to defraud.)

C. Mail/Wire Fraud.

1. Mail Fraud, 18 U.S.C. §1341. (Covers schemes where the mails are used to defraud, even if the mailing is not an essential element of the scheme.)

2. Wire Fraud, 18 U.S.C. §1343. (Also reaches television and radio.)

D. Obstruction of Justice, 18 U.S.C. §§1501 *et seq.*

E. Bribery or Gratuities to Federal Officials, 18 U.S.C. §201.

F. Bribery in Federal Programs, 18 U.S.C. §666.

G. Foreign Corrupt Practices Act, 15 U.S.C. §§78dd-1, *et seq.* (Prohibits bribery of officials of foreign governments or public international organizations.)

H. Tax Violations, 26 U.S.C. §§7201, *et seq.*

1. Tax Evasion, 26 U.S.C. §7201. (Requires specific intent to evade or defeat the payment of tax, Cheek v. U.S., 498 U.S. 192 (1991)).

2. Willful Failure to File a Return, 26 U.S.C. §7203.

3. Fraud and False Statements, 26 U.S.C. §7206. (Requires that the false statement be provided under penalty of perjury.)

4. The Aiding and Abetting Statute, 26 U.S.C. §7206(2).

5. The Misdemeanor False Statement Statute, 26 U.S.C. §7207. (Criminalizes willfully false statements not made under penalty of perjury.)

I. Theft from Interstate Shipments/Receipt of Stolen Property.

1. The Interstate or Foreign Shipments by Carriers, 18 U.S.C. §659.

2. Transportation of Stolen Goods, 18 U.S.C. §2314. (Requires that transporting defendant know that goods were stolen or fraudulently obtained. Covers wire transfers.)

3. Sale or Receipt of Stolen Goods, 18 U.S.C. §2315. (Requires that receiving defendant know that goods were stolen or obtained by fraud.)

J. Racketeer Influenced and Corrupt Organizations (RICO), 18 U.S.C. §1961, *et seq.*

K. Money Laundering.

1. Laundering of Monetary Instruments, 18 U.S.C. §1956.

2. Receipt of Illgotten Gains, 18 U.S.C. §1957.

3. Trades and Business Reporting, 26 U.S.C. §6050I.

L. Currency Transaction Reporting.

1. Reporting Requirements for the Export and Import of Monetary Instruments,

31 U.S.C. §5316, 5317. (Requires report when more than $10,000 in monetary instruments enters or exits the U.S.)

2. Structuring Transactions, 31 U.S.C. §5324. (Criminalizes structuring a transaction to avoid the reporting requirement, for instance by breaking it up into several transactions under $10,000. Requires that defendant purposefully structure the transactions to evade a known reporting requirement, but does not require that defendant know the structuring itself is unlawful.)