

## The Impact of Criminal Sanctions on Corporate Misconduct

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## CRIMINALIZATION OF CORPORATE LAW

### The Impact of Criminal Sanctions on Corporate Misconduct

I FEEL I HAVE NO CHOICE BUT TO GIVE SOMETHING LIKE A resounding endorsement of corporate criminal liability just so we will have an alternative view. I am not going to give an entirely resounding endorsement, but I want to defend it a little bit to try to bring out the other side.

I am sympathetic to the view that we need corporate criminal liability in order to give corporate managers adequate incentives to police misbehavior.<sup>1</sup> I think one can quibble about whether the corporation's liability should be civil or criminal, but the incentive effect strikes me as a plausible justification for corporate civil liability at the least, and arguably for criminal liability as well. It is true, of course, as has been noted a number of times, that corporations are not things,<sup>2</sup> but corporations do have identifiable cultures.<sup>3</sup> Enron certainly had an identifiable culture,<sup>4</sup> and so to say "there is no there there," to quote Gertrude Stein, is, I think, a little bit of an overstatement.

I want to make four additional points and they are going to go in different directions, but let me just throw them out. First, we have not said much about why corporate employees commit crimes. It seems to me that this might be worth exploring. One pressure that encourages corporate employees to misbehave in many corporations is the system of compensation.<sup>5</sup> So the debates about the causes of the

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1. Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 42 N.Y.U. L. REV. 687, 692–95 (1997); Vikramaditya S. Khanna, *Corporate Liability Standards: When Should Corporations Be Held Criminally Liable?*, 37 AM. CRIM. L. REV. 1239, 1245 (2000). But see Michael A. Perino, *Enron's Legislative Aftermath: Some Reflection on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76 ST. JOHN'S L. REV. 671, 687–90 (2002).

2. Sean J. Griffith, *Afterward and Comment, Towards an Ethical Duty to Market Investors?*, 35 CONN. L. REV. 1223, 1252 (2003); see generally David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 229–31 (1990).

3. Pamela H. Buey, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 MINN. L. REV. 1095, 1123 (1991).

4. Ronald R. Sims & Johannes Brinkman, *Enron Ethics (Or: Culture Matters More Than Codes)*, 45 J. BUS. ETHICS 243 (2003).

5. See Kimberly D. Krawiec, *Accounting for Greed: Unraveling the Rogue Trader Mystery*, 79 OR. L. REV. 301, 308–14 (2000) (discussing the trader's cost/benefit analysis).

corporate scandals of the 1990s, such as the effect of stock options, are, I think, quite relevant to our discussion of corporate criminal liability.<sup>6</sup> To the extent a corporate employee's compensation is heavily based on short-run profits or short-run performance measures of some sort, there is an incentive to cut corners.<sup>7</sup> If we are concerned about this, it seems to me that it is worth considering whether corporate criminal liability is a possible antidote, or antidote to some kinds of corporate misbehavior, and if not, why not.

The second of the four points I want to make is related to something we have already discussed a lot this morning. It seems to me that it is important to reward cooperation by the corporation with an investigation if our goal is to encourage corporate employees to behave. If a company puts a compliance program in place that dredges up evidence of misbehavior, for instance, its managers will have a disincentive to disclose that misbehavior unless they are somehow rewarded for the disclosure.<sup>8</sup>

Third, we have talked a lot already about the fact that cooperation with the government ends up putting a lot of power in the prosecutor's hands. So what do we do about all of this? It seems to me that an obvious partial solution, which has been hinted at a little bit already, is to think in terms of the scope of liability. To the extent we have corporate criminal liability, ideally it would be extremely narrow.

The problem with advocating narrow, tailored liability—and this is where I am going to jump to the other side of the fence and criticize corporate criminal liability—is that all of the political incentives point in exactly the opposite direction.<sup>9</sup> Think about what happens when there is a new form of high profile misbehavior. The first thing that happens is people talk about enacting a new criminal law to punish that behavior. If you are a lawmaker, how do you think about the proposed law? You do not think “Well, it is probably not a good idea, because in ten years we will have second thoughts about this. I am going to vote no on it.” You are going to vote yes, because if you vote no you are going to be an ex-lawmaker pretty quickly.

So there is a huge incentive to criminalize things<sup>10</sup> and there is really no punishment to lawmakers who vote yes, even if the new law is a terrible idea. If it turns out ten years from now that the sweeping catchall anti-fraud provision in Sarbanes-

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6. See David Millon, *Why is Corporate Management Obsessed with Quarterly Earnings and What Should Be Done About It?*, 70 GEO. WASH. L. REV. 890, 907–08 (2002) (discussing stock option incentives).

7. Robert Prentice, *Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for Its Future*, 51 DUKE L.J. 1397, 1424–25 (2002).

8. See Christopher A. Wray & Robert K. Hur, *Corporate Criminal Prosecution in a Post-Enron World: The Thompson Memo in Theory and Practice*, 43 AM. CRIM. L. REV. 1095, 1171 (2006).

9. See generally William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 MICH. L. REV. 505, 529–33 (2001); Vikramaditya S. Khanna, *Corporate Crime Legislation: A Political Economy Analysis*, 82 WASH. U. L.Q. 95, 125–26 (2004) [hereinafter Khanna, *Corporate Crime Legislation*].

10. Khanna, *Corporate Crime Legislation*, *supra* note 9, at 124–26; Stuntz, *supra* note 9, at 525–33. See generally Michael A. Simmons, *Prosecutorial Discretion and Prosecution Guidelines: A Case Study in Controlling Federalization*, 75 N.Y.U. L. REV. 893, 906 (2000).

Oxley<sup>11</sup> is a disaster, no lawmaker is going to get punished for that. There might be a prosecutor who gets punished for invoking it in a dubious case, but lawmakers will not get punished. There is thus an obvious tension between the kind of corporate liability that makes sense—that is, narrowly tailored liability—and the political pressures that lawmakers face to criminalize everything in sight.

Finally, an almost entirely unrelated point, just to throw out another aspect of the question of sanctions, I think it is worth thinking about whether “shaming sanctions”<sup>12</sup> are appropriate or not. Most of what other folks have said on this panel would suggest no, but I actually think they are useful in some contexts.<sup>13</sup> I think requiring a corporate polluter to publish something in the local newspaper of record apologizing for its actions, for instance, can serve some useful functions.

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11. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended at 18 U.S.C. § 1348 (2002)).

12. David A. Skeel, *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1812 (2001).

13. *Id.*