THE UNITED STATES SENTENCING COMMISSION
1331 PENNSYLVANIA AVENUE, NW
SUITE 1400
WASHINGTON, D.C. 20004
(202) 662-8800

October 13, 1988

MEMORANDUM:

TO: Commissioners
Staff Director
Legal, Drafting & Research Staff

FROM: Paul K. Martin PC

SUBJECT: Written Submissions from New York Hearing

Attached for your review are copies of the written statements submitted by seven of the witnesses at the recent New York City Public Hearing. Additional comment will be circulated upon receipt.

A transcript of the proceeding is expected within two or three weeks. Upon arrival, a copy will be placed in the library.

Attachments

Statements:
Tom Moore, Council of Economic Advisers
Sam Buffone, American Bar Association
Gary Lynch, Securities & Exchange Commission
Ron Cass, International Trade Commission
Jack Coffee, Columbia University Law School
Harry First, New York University Law School
Jonathan Baker, Dartmouth College

COMMISSIONER

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

October 12, 1988

Honorable Ilene Nagel
U.S. Sentencing Commission
1331 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear ~~Commissioner~~ Ilene:

It was nice to see you briefly, even if we didn't get an opportunity for an extended chat. Good luck with the organizational sentencing decision. It's a tough area, which makes me quite comfortable giving advice from the sidelines.

Best regards,

Ronald A. Cass

Copyright Protected Articles in Ilene Nagel's files. Box # L0150

"Commissioners, Witnesses Split Along Ideological Lines AS U.S. Sentencing Commission Holds New York City Hearing on Corporate Criminal Sanctions", Corporate Crime Reporter, Vol 2, No. 39, Monday, October 17, 1988.

STATEMENT BY THOMAS G. MOORE
MEMBER, COUNCIL OF ECONOMIC ADVISERS
BEFORE THE
UNITED STATES SENTENCING COMMISSION
UNITED STATES COURTHOUSE, FOLEY SQUARE
NEW YORK, NEW YORK

Tuesday, October 11, 1988

My name is Thomas Gale Moore, and I am a Member of the Council of Economic Advisers, located in the Executive Office of the President. I recently chaired an interagency Working Group on Corporate Sentencing that prepared a memorandum for the Domestic Policy Council (DPC). The DPC subsequently adopted the position taken by this memorandum as the official statement of Administration policy concerning the principles that should govern corporate sentencing. That memorandum was previously submitted to this Commission in April, 1988.

Having reviewed the Discussion Draft of Sentencing Guidelines of July, 1988 (the "Draft Guidelines"), I am pleased to note that these Draft Guidelines conform in most significant respects with the principles set forth in the DPC memorandum. I would also like to commend the Commission for including with its discussion materials the insightful staff working paper prepared by its Deputy Chief Counsel, Jeffrey Parker. I am concerned, however, with certain aspects of those Draft Guidelines. I would like to take this opportunity to briefly comment upon the Draft Guidelines' approach in several areas.

I applaud the Draft Guidelines for adopting the deterrence approach to sentencing, and for recognizing that deterrence-based penalties simultaneously satisfy the need for a "just punishment" of criminals. The offense loss/offense multiple/enforcement cost formula utilized by the Draft Guidelines will serve to establish penalties that accurately reflect the severity of harm caused by a crime--thus "fitting the crime"--and which will be set at a level that substantially exceeds the harm caused by that crime, so as to compensate for the less than certain probability of apprehension. It is thus not necessary to increase or decrease a fine from the level appropriate to achieve deterrence in order to achieve a just punishment.

It is particularly inappropriate to vary the size of fines on the basis of the size of the offender or, what amounts to essentially the same thing, on the basis of whether the offender is privately or publicly held. There is obviously nothing criminal about "bigness," per se, and the harm caused by a particular crime is unrelated to offender size. Such variation in fines would act to underdeter small offenders, relative to the harm caused by their behavior, overdeter large offenders, or both. The DPC for these reasons expressly rejected the use of offender size as a factor in determining penalty levels, and I am pleased that the Draft Guidelines also take this position.

Any guidelines adopted to govern organizational sentencing must be based on a candid recognition of the fact that crime prevention, as well as crime, is costly, and that society as a whole will suffer welfare losses if firms undertake internal crime prevention measures that are more costly than the crimes thereby prevented. It is important that penalties be set so as to provide the proper level of deterrence to encourage firms to undertake the proper level of internal control. It cannot be overemphasized that efforts by corporations to monitor their agents' compliance with the law are costly. Excessive penalties overdeter crime, and are economically inefficient since they will lead to excessive compliance expenditures by firms that seek to avoid violations, just as inadequate penalties underdeter crime, and are inefficient because they make it profitable for firms to engage in criminal behavior. I therefore strongly support the position taken by the Draft Guidelines that the optimal level of deterrence is provided by a fine which accurately reflects the severity of harm caused by a crime, as adjusted to take into account the probability of apprehension and cost of enforcement.

I also support the Draft Guidelines' focus upon victim losses, rather than offender gains, as the basis for establishing penalties. The social harm caused by a crime, rather than the gain to the criminal, is the proper measure on which to base the penalty, since the primary goal of the criminal law is ultimately to prevent uncompensated harm to victims. A fine calculated on the basis of social harm caused, utilizing the formula proposed by the Draft Guidelines, accurately "internalizes" the cost of the crime, and thus provides the economically optimal level of deterrence. Fines that are instead based on the size of the gain to the offender will not accurately reflect the magnitude of harm caused, and will be normally much too low and fail to adequately deter. On the other hand, fines that are excessive and aimed at establishing "absolute deterrence" would work to impoverish society by motivating firms to devote more resources to crime prevention than the harms thereby avoided justify.

I concede the point made by some critics of the Draft Guidelines that it will be difficult in some instances to quantify the amount of social harm caused by a crime, and to determine the probability of apprehension. However, the optimal penalty approach followed by the Draft Guidelines is conceptually correct, and is the only approach with any promise for establishing optimal deterrent levels. Courts regularly grapple with the difficulties of quantifying harmful consequences of behavior, often of a "non-economic" character, and there is no reason why non-economic consequences cannot be considered and quantified in penalty calculations. Courts regularly award damages for loss of life, limbs, reputation and amenities, all of which are difficult to quantify.

The Draft Guidelines should perhaps be revised to make it more clear that courts should consider the full range of social harms resulting from a crime in determining the appropriate offense loss figure. These might include in bribery cases, for example, the harm done to society by reducing respect for governmental processes.

It would also be helpful for implementation purposes if the Draft Guidelines were revised to incorporate at least suggested "rules of thumb" that judges could use to estimate the magnitude of the more diffuse and difficult to quantify social harms. Such rules of thumb would help lessen the evidentiary problems involved in determining damages at sentencing hearings, and would consequently reduce the effort and expenditure involved in applying the guidelines.

The Draft Guidelines are consistent with Administration policy that probation should be used primarily as a means of enforcing other court-imposed sanctions, and not as an independent sanction. The prospect of being subjected to probation is unlikely to provide an optimal level of deterrence, since it is virtually impossible for a firm to estimate the economic cost of probation. In many cases, substituting probation for a fine would lead to under-deterrence. Often probation is simply a slap on the wrist. Probation, being so open-ended, can also lead to economically wasteful "absolute deterrence" efforts by firms, and correspondingly excessive compliance expenditures. The uncertain cost and consequent uncertain deterrence of probation argues against it.

The DPC has expressed its concern that "probation could be used to set up ongoing monitoring by the courts of private firms," an area in which judges have little experience or expertise. Since firms are essentially rational economic actors, and their managers know better than anyone else how to direct their activities effectively, it makes much more sense to establish the proper behavioral incentives through optimal fines, and then let firm managers respond to those incentives and devise and implement the proper measures to police firm agents adequately.

Probation is not a good remedy even for recidivist organizations. A firm that has been formerly convicted of a related offense and has broken the law should face stiffer penalties. There are two reasons for this. First, the organization has presumably learned from its first conviction, and the fact that it broke the law again suggests that it thought it had developed a less detectable criminal activity. Moreover, the fact that it broke the law the second time (or subsequent times) indicates that the level of fine was inadequate to deter. Either the harm estimate or the multiple was too low. Hence, a higher fine, rather than probation, is warranted for repeat offenders.

While the Draft Guidelines at Sections 8D2.1 and 8D2.5 do provide some protection against the abuse of probationary conditions by an activist court, I have some concern that those restrictions are sufficiently loose so that probation could be used to direct organizational activities in a manner only tangentially related to the legitimate goals of corporate sentencing. I would suggest that the Commission give serious thought to narrowing the conditions under which probation can be imposed.

One of my concerns about the Draft Guidelines relates to the handling of collateral sanctions. Economic theory suggests that the optimal penalty for a crime, once determined, should be regarded as the total penalty, civil as well as criminal, that should be imposed upon all participants in the crime. It is therefore necessary for a deterrence-based guideline structure to allocate this penalty, by allowing offsets against the organizational criminal sanctions for amounts paid as collateral civil or criminal penalties by the firm, its agents, or by joint offenders. Otherwise, the aggregate penalty will be excessive, and will act as an inefficient overdeterrent.

The Administration has endorsed the allowing of such offsets in the DPC memorandum. The Draft Guidelines also do so in their prefatory material, although not as clearly as could be done. Sections 8C5.6 and 8C5.7 also provide for offsets due to penalties imposed against agents or joint offenders. However, Section 8C5.5 of the Draft Guidelines states that collateral penalties against the firm offender shall provide a basis for reduction of a criminal penalty only if there are "unusual circumstances" affecting the imposition of collateral penalties, or if the combined effect of the criminal and collateral penalties is "disproportionate" to the "detectability" of the offense. Moreover, in the commentary to that section it is stated that the prospects of recovery of collateral penalties are taken into account in determining the offense multiples, and unless collateral penalties against the firm are "significantly higher" than is ordinarily the case, no compensating reduction in the criminal fine is called for.

This is an incorrect approach, given the Guidelines endorsement of deterrence-based penalties. Since the offense loss figure is, under the Draft Guidelines, calculated so as to approximate the total social harm caused by the offense, the criminal penalty calculated under the Draft Guidelines' formula should subsequently be reduced by any collateral penalties imposed against a firm, lest certain harms be "double-counted," and an overall sanction imposed which is too large.

I have two final comments regarding the Draft Guidelines' penalty calculation formula. First, under this formula as set forth in Section 8C1.1 only actual enforcement costs are added to the penalty amount. Some persons have suggested that those enforcement costs should first be increased by some multiple, perhaps by the offense multiple, so as to allocate to convicted offenders some of the "overhead" costs of enforcement activities that do not result in successful prosecutions. This suggestion has merit, and I would recommend that the Draft Guidelines formula be revised so as to add actual enforcement costs to the offense loss figure before the resulting sum is multiplied by the offense multiple.

Let me briefly explain this point. The rationale for multiplying the offense loss calculated for a crime by an offense multiple is that even if the criminal is not apprehended, the crime imposes costs upon society, and a fine must be set at a multiple of that offense loss to present a prospective criminal who may escape apprehension with an adequate deterrent. Many crimes result not only in harm to society but also trigger an investigation-related enforcement effort which results in real costs, whether or not the criminals are apprehended. It is thus also necessary to include a multiple of actual enforcement costs in the penalty to reach the total social costs and to present prospective offenders with adequate deterrents. As a theoretical matter, in some cases the appropriate multiple for enforcement costs of a crime is likely to be somewhat less than the offense multiple applied to the offense loss, since there are crimes that are not detected and thus generate no additional enforcement costs. The ideal enforcement costs multiples might even vary from crime to crime independent of changes in the probability of apprehension of the criminal, depending on how likely it was that a given type of crime itself would escape detection.

In the interest of practicality and ease of application of the Guidelines, it would appear to be justified to act as if all crimes were detected and led to enforcement efforts, although the perpetrators cannot always be identified and punished, and therefore to simply multiply the actual enforcement cost of a successful prosecution by the applicable offense multiple in order to have the fine properly reflect enforcement costs. Such an approach is consistent with the Administration position taken in the DPC memorandum, which stated that some portion of enforcement costs should be included in the estimate of the harm caused by a crime _before_ that estimate is multiplied by a figure based upon the probability of detection.

A second comment I have regarding the penalty calculation formula concerns the size of the offense multiples. The Draft Guidelines provide for base offense multiples of 2.0 and 2.5, and for a total range of offense multiples from 1.0 to 3.5. These multiples indicate implicit acceptance of a base probability of apprehension of 40 to 50 percent, and a total range of between 28 percent and 100 percent. While I have not seen any definitive data regarding actual apprehension rates, those implicit probabilities strike me as being significant overestimates of the chances that criminal behavior will be successfully detected and punished. My suspicion is that offense multiples of between five and ten are probably justified for at least some offenses. I recommend that the Commission make special efforts to obtain the best data available on actual apprehension rates, and subsequently make any revisions needed in the offense multiples to reflect that data.

I thank you for giving me the opportunity to offer these remarks.

AMERICAN BAR ASSOCIATION
GOVERNMENTAL AFFAIRS OFFICE • 1800 M STREET, N.W. • WASHINGTON, D.C. 20036 • (202) 331-2200

STATEMENT OF

SAMUEL J. BUFFONE, CHAIRPERSON
COMMITTEE ON THE U.S. SENTENCING GUIDELINES
SECTION OF CRIMINAL JUSTICE

ON BEHALF OF
THE AMERICAN BAR ASSOCIATION

BEFORE THE
UNITED STATES SENTENCING COMMISSION

CONCERNING

ORGANIZATIONAL SANCTIONS

OCTOBER 11, 1988

Mr. Chairman and Members of the Commission:

My name is Samuel J. Buffone. I appear today to testify on behalf of the 350,000 members of the American Bar Association. I serve as Chairperson of the American Bar Association's, Criminal Justice Section, Committee on the United States Sentencing Commission. My own practice is focused on white collar criminal law and involves representation of organizational defendants in the criminal process.

In the past I have appeared and testified before the Commission and Committees of the United States Congress in order to address the ABA's continuing support for the concept of Federal Sentencing Guidelines and Federal sentencing reform. While we have not agreed with every action taken by the Commission or by Congress in this important area, we recognize the significant progress made towards our shared goal of sentencing reform.

As you are aware from our past testimony our position is founded in the Association's 25 year history of development and refinement of its Standards for Criminal Justice (Standards). We are gratified that the Commission chose to include Chapter 18 of the Standards dealing with organizational sanctions in its discussion materials .

I would like to commend the Commission for the issuance of its discussion materials and the openness with which you have approached the difficult questions associated with organizational sanctions.

During my last appearance before the Commission I expressed the Association's concern that the Commission's process be as open and public as possible. The Commission's decision to release the discussion draft and related materials and to hold these public hearings deserves commendation. While there may be those who will criticize the Commission for not promptly staking-out a definitive position in this complex area, we believe that such criticism is unfounded. Our analysis of the long history of judicial efforts to deal with organizational sanctions indicates that there has never been a consensus position on how best to achieve societal ends in the sentencing of organizations. The Commission's decision to present a detailed working model accompanied by discussion materials will hopefully spawn the type of debate and public comment that will permit the Commission to move towards a solution of this thorny problem.

The presentation of the detailed proposed guidelines permits focused public comment and hopefully a narrowing of the areas of dispute over the proper course for the Commission to take. This task is significantly advanced by the inclusion of the discussion materials which provide a detailed explanation of the rationale for the proposed Guidelines and more importantly an analytical framework for evaluating the potential range of choices that face the Commission.

We are hopeful that the Commission will continue with this process following these public hearings and those to be conducted in Los Angeles. We urge the Commission to consider the information presented and to issue a second revised set of Guidelines on organizational sanctions for additional public comment. This process will permit the Commission to make adjustments, or indeed perhaps major changes,in course. We offer our support to such a project and once again wish to applaud the Commission for its dedication to an open and public process.

We find much that we agree with in the Commission's proposed draft. In particular, the proposed Guidelines parallel the ABA Standards in several significant respects. They adopt the range of sanctions approach which provides a flexible yet effective array of alternative sanctions. The Guidelines recognize the need for coordination between criminal penalties and civil and administrative remedies. Similarly, the proposed Guidelines recognize the compelling need to bring uniformity and predictability to sentencing of organizations and to provide for substantial enough penalties to ensure public confidence in the government's ability to curtail organizational criminality.

We will not, however, in these comments dwell on our agreements with the Commission. Rather, we would like to draw your attention to those areas that we believe deserve further consideration. The Commission has listed twelve subjects and issues for public comment. We have chosen in this testimony to not address each of the Commission's specific areas of inquiry. The time constraints inherent in volunteer bar activity and the geographic separation of our members has precluded formulation of positions on all of these issues. We hope to address some of these additional issues in supplemental written testimony before the Commission closes its comment period.

We glean from the these areas of inquiry that the Commission wishes to receive comment of not only the wisdom of specific draft guidelines but also the entire approach it has utilized. We have grave reservations in three areas. First we question the desirability of formulating specific guidelines in the absence of sufficient data to establish past practice. As a practical matter the new remedies and enhancements on old ones worked by the Sentencing Reform Act has created an entirely new era for organizational sanctions. We believe that historic data is of little value in determining how to properly use these new and enhanced sanctions.

We urge the Commission to not rely upon an unproven theoretical model as the basis for moving to a determinative system. Our second concern is the reliance on the loss based optimal penalty theory. The exclusive reliance on loss may create anomalies in application. Additionally it places great strain on the fact-finding process by requiring complex factual determinations on loss, probability of detection and enforcement costs. Finally we have concerns about the use of any arbitrary multiplier.

While the draft guidelines have the benefit of providing uniformity and determinacy they do so at a high cost. That cost is the untried nature of both the theoretical model that drives the draft guidelines and the absence of the leveling effect that was brought to the Commission's initial guidelines by basing them on past practice.

We urge the Commission to consider a trial period during which organizational sanctions would be governed by general commentary and a few broadly worded guidelines. During this period the Commission could carefully monitor organizational sentences and slowly move toward a firm set of guidelines. It is just such a flexible model that is suggested by our own Standards as they relate to organizational sanctions. In the event that the Commission deems it necessary to adopt detailed guidelines we suggest consideration of the following issues.

1. Does the Commission's use of economic analysis, through its optimal penalty theory, provide the necessary basis for adoption of the loss based approach of the Guidelines?
2. Has the Commission adequately considered the potential objectives of punishment deterrence and rehabilitation in the unique circumstances of organizational sanctions?
3. Should offender characteristics be given greater consideration for organizations?
4. Do the proposed Guidelines unnecessarily limit the discretion of sentencing judges and would the introduction of additional discretion run counter to the need for uniformity and a lack of disparity?
5. Is the Commission's use of a multiplier for fines appropriate and is it possible to quantify enforcement costs and probability of detection?
6. Should the Commission issue specific guidelines on plea bargaining regarding organizational sanctions?
7. Would the proposed Guidelines result in unnecessarily complicated fact-finding by the sentencing court?
8. Should the Guidelines address in more detail an enforcement mechanism?

I. THE ABA STANDARDS.

Our Standards begin with the universally accepted and quite simple observation that organizations cannot be incarcerated. This simple fact, and others unique to organizations, present problems of prevention and punishment distinct from those involving individuals. A critical component of the Standards is the availability of a variety of sentencing alternatives. ABA Standard 18-2.8 suggests alternative sanctions including: restitution, special fine schedules, disqualification from office, notice of conviction, and continuing judicial oversight. While there are slight differences in terminology and scope, the proposed Guidelines adopt this multiple sanction approach and incorporate each of these sanctions to varying degrees.

The Standards recognize the unique problems associated with deterring corporate criminality and the importance of fines, restitutionary remedies and even intervention in the corporate process as necessary means of combatting this problem. The Commentary to the Standards concludes that there is no single optimal sanction for organizational crime. They recommended adoption of more flexible models along the lines of those available to the Securities and Exchange Commission (FTC) and the

Federal Trade Commission (FTC). While the Standards' approach to restitution largely parallels those of the Guidelines, there are significant differences in the treatment of fines. Most importantly, the Standards disapprove of any fine multiplier. The commentary recognizes the limitations of fines as a deterrence vehicle and the potential consequences of excessive fines on shareholders and consumers.

The Standards reject any probationary model as an inapplicable misnomer and instead focus on the nature of the intervention in the corporate process that is appropriate or effective. The Standards and the draft Guidelines are nearly identical on notices of conviction. Significant differences exist between the Standards and the Guidelines on the appropriateness of probation or the necessary levels of judicial oversight.

Finally, the Standards at 18-2.8 (b) provide for three general restrictions on the imposition of any organizational sanction. First, the Standards recognize that sanctions of restitution, enhanced fines and continuing judicial oversight should not be imposed in cases where government or private civil actions for equitable relief, money damages or civil penalties otherwise accomplish the remedial or deterrent purposes of the sanction. While the proposed Guidelines address this issue and the need for coordination, they do not strike the same balance as the Standards. The second general restriction is that sanctions only be imposed after a full adversary hearing. This same position was adopted in the Commission's initial Guidelines and has been extended to its proposals on organizational sanctions. Similarly the third restriction suggesting the availability of appellate review of any sanction has been incorporated in the Sentencing Reform Act.

In summary, there are significant parallels between the Standards and the proposed Guidelines. The most significant parts of the Standards have been adopted in the proposed Guidelines. We urge the Commission, however, to examine those areas of disagreement. The Commission's loss-based optimal penalty model incorporates these features of our Standards but departs in significant respects. The result is that the flexibility and workability of the Standards is lost.

II. <u>THE COMMISSION SHOULD RE-EXAMINE THE BASIC PRINCIPLES UNDERLYING ITS LOSS BASED APPROACH</u>.

The staff working paper entitled "Criminal Sentencing Policy for Organizations" authored by Jeffrey S. Parker appears to present much of the underpinning for the draft Guidelines. Mr. Parker discusses at length an optimal penalty theory which adopts a loss-based approach increased by a multiplying factor designed to reflect cost of enforcement and difficulty of detection. The model is based upon economic analysis of a deterrent view of sentencing. The end result is a system that relies on the monetary sanctions of fines, forfeitures and restitutions as the principle components of organizational sanctions.

While we agree with the Commission's reliance on monetary sanctions, and specifically fines, we disagree with some of the mechanics the Commission suggests for computing them. Our disagreement is based upon a differing view of the nature and purpose of organizational sanctions. We are in agreement with the Commission's position that non-monetary sanctions must be available and that criminal and civil sanctions should be coordinated. We do disagree, however, with what we view as a disproportionate emphasis on the deterrent effect of monetary sanctions.

In the introduction to the Federal Sentencing Guidelines Manual the Commission addressed the problems it encountered in reconciling various philosophical approaches towards the perceptions and purposes of criminal punishment. It noted the on-going debate between the just deserts, deterrent and rehabilitative models of criminal sentencing. The Commission, in our view wisely, refused to adopt any philosophical model but rather drew upon a broader body of information in formulating its Guidelines. The Commission was able to do this by virtue of its adoption of an empirical approach. By relying on its 10,000 case data base it was able to adopt Guidelines that were largely reflective of prior experience rather than being the product of an untested philosophical model of sentencing.

We agree with the position expressed by Mr. Parker that available data cannot be relied upon as the basis for formulating organizational standards. As Mr. Parker noted:

> "[G]iven the relatively small number of organizational prosecutions and the recent revisions to statutory fine authority, a predominantly empirical approach relying on past practice is unlikely to provide an adequate and consistent basis for organizational sentencing reform."

Staff Working Paper," Criminal Sentencing Policy For Organizations" at page 2.

Additionally, the available data contained in the "Report to the U.S. Sentencing Commission on Sentencing of Organizations in the Federal Courts, 1984-1987", indicates that the relatively small number of organizational sentences and lack of significant data in particular categories of organizational criminality precludes reliance on such data in formulating overall policy. Mr. Parker went on to identify additional reasons why empirical analysis of past sentencing practices was unlikely to provide a "fully satisfactory basis for organizational guidelines." Id. at 25.

In detailing the sentencing options available to the Commission Mr. Parker first recognized the Congressional rejection of any organizational equivalent to imprisonment. Despite recent actions by at least one federal district court judge, attempts to impose any incarcerative type sentence on organizational defendants have been unknown to our legal system. We concur in the rejection of any novel or untested corporate sanctions that involve excessive governmental intrusion into the corporate decision making process. Mr. Parker then went on to define a number of objectives that organizational sanction guidelines should accomplish. While we agree with most of what it set out in the seven factors isolated by Mr. Parker, we disagree with some of the conclusions derived therefrom.

Mr. Parker's paper, and the Guidelines, are based on a rigid perception of the need for determinacy. While we appreciate that the Sentencing Reform Act had as one of its fundamental objectives the elimination of disparity, in our view it does not call for a completely determinative model. We will address later in this testimony our view of a need for more flexibility in sentencing discretion. Our views are based upon the unique nature of the problems facing a judge in fashioning organizational sanctions and in particular the wide diversity of organizational structures and potential range of criminality and harm that are impossible for the Commission to assess in fashioning any prospective determinant model. Accordingly we disagree with the assessment that there is a need for sentences that can be translated into quantitative units of punishment. Mr. Parker, contrary to the position taken by the

Commission in its original Guidelines, perceives the need for a unifying philosophy or at least a predominant theory.

In the draft Guidelines the Commission appears to have adopted the optimal penalty deterrence model set forth in Mr. Parker's paper. The basic underpinning of this approach is that organizational sanctions are susceptible to quantitative financial units of punishment and that these units can be optimally determined by a combination of two factors:

1. Societal loss; and
2. The probability of detection and punishment.

The total sentence is a multiple of these two factors. Underlying this approach is a view that organizational behavior will be modified by a perception that the cost of criminality outweighs any inclination to assume risk. It is at its base a deterrence model. Once the Commission has determined that this deterrence model is necessary it follows that a more inflexible schedule of substantial monetary penalties will meet the model's predictive needs.

We urge the Commission to reject any perceived need to adopt a philosophical underpinning to its approach to organizational sanctions. We suggest in the alternative that like our Criminal Justice Standards the Commission adopt a flexible approach to organizational sanctions that attempts to incorporate all available data in formulating a broad range of organizational sanctions. We do not mean to suggest by these comments that we are unmindful of the substantial problems facing the Commission in adopting organizational sanctions. We recognize that the unavailability of incarcerative sentences and the limited range of corporate sanctions limits the Commission's discretion. We additionally recognize that there is a need for predictability and uniformity in organizational sanctions. The Standards, however, reject that there is a single optimal standard and implicitly reject any formula for determining optimal standards. Rather, they rely upon the experience of the SEC and FTC in formulating flexible remedies for varying situations.

Second, the Standards attempt to incorporate a realistic view of the conduct of business in corporate and other organizational forms in our economy. While the Standards specifically reject any formulation of economic sanctions that would create a "heads I win, tails we break even" view of penalties by corporate defendants, they emphasize the compelling need to not impose excessive financial penalties.

III. THE GUIDELINES SHOULD GIVE GREATER CONSIDERATION TO OFFENDER CHARACTERISTICS.

The Commission's data base indicates that of the 1,221 organizations convicted and sentenced during the four year study period virtually all were for profit business corporations. Of this sample less than 15% were characterized as well-known corporations. Only 11% of the charged organizations were listed in Standard and Poor's 1987 Register of Corporations and only 2% of the organizations were listed directly or as subsidiaries to "Forbes 500" corporations. Accordingly, the staff working papers conclude that sentenced organizations are primarily business firms motivated solely by economic incentives. The Guidelines conclude that monetary sanctions are the best available sanction to modify or deter illegal corporate behavior. The draft Guidelines, however, do not permit consideration of any unique characteristics of organizational defendants that might influence these assumptions.

The potential breadth and diversity of corporate and organizational criminality requires more flexibility in the sentencing court than is permitted under the draft Guidelines. In particular this flexibility should take into consideration offender characteristics. A few examples may illustrate this point.

Under federal criminal law a corporation is responsible for the acts of its agents performed within the scope of his employment or authority and for the benefit of the organization regardless of the role of the employee in the organization. Accordingly a corporation can be held liable for the acts of low-ranking employees or outside agents even though these agents acted without any knowledge, authorization or participation by corporate management.

A major national corporation with numerous operating branches around the country could find itself criminally responsible for the actions of a low-level employee in a remote area of the country. While the Guidelines recognize that in such situations corporate intervention may be appropriate in order to ensure that information is gathered and transmitted to responsible management, the draft Guidelines would still require the imposition of a substantial fine if the crime were a serious one. While a fine or monetary penalty might be appropriate, the court should be free to consider the degree of responsibility of corporate management before imposing sentence. Although the draft Guidelines recognize departure authority it may be difficult to establish that vicarious liability was not a factor adequately considered by the Commission.

Similarly, the importance of a corporation's product or services to the economy as a whole may be a relevant consideration. For example, if a small defense contracting firm is the sole source of a component vital to national defense or at the cutting edge of emerging technologies important to our national economy, these offender characteristics should be considered in the imposition of monetary sanctions. It would be difficult to argue that a judge has departure authority for these kinds of offender characteristics when the draft Guidelines make it clear that offender characteristics are not considered in the first instance.

It is for these reasons that the ABA Standards recommend flexible discretion in the sentencing court to draw upon the range of available corporate sanctions. Judicial oversight may often be appropriate as a substitute for monetary sanctions rather than as an additional penalty. The Guidelines should clarify that corporate supervision or probation is available as an alternative to or in conjunction with monetary sanctions.

The draft Guidelines in Chapter 5 address these issues and provide for some relief. Section 8C5.1, however, does not provide any basis for departure from the Guidelines for the kinds of examples cited above. Rather, the departures would be considered under the Commission's more general departure standard based upon past adequate consideration of the factor by the Commission. Section 8C5.6 provides for consideration of penalties against organizational agents. While this section will provide some protection where an individual has been found responsible for an organization's participation in an offense, it does not deal with the situation outlined above where the corporation's vicarious liability is the result of the actions of a minor corporate employee.

Section 8C5.5 provides for consideration of collateral civil penalties and disabilities as a basis for increasing or decreasing an organization's fine. This is an extremely significant section of the draft Guidelines. It parallels a section of the ABA Standards requiring coordination of civil administrative and criminal sanctions. Standard 18-2.8D(i) provides that monetary sanctions should not be imposed where there are adequate civil remedies available. In addition the standards contemplate coordination between all available remedies. The Guidelines similarly favor coordination of such penalties.

The practical realities of federal enforcement of complex regulatory and criminal statutes appears, however, to make this a difficult task. A court at the time of sentencing may not be aware of the full scope of civil and administrative enforcement actions pending against an organizational defendant. The commentary to section 8C5.5 suggests that this factor be considered as bearing on the multiplier since it reflects on the probability of detection. We suggest that departures be based not on difficult to quantify perceptions of detectability but rather coordination with overall civil and administrative penalties. This task may be particularly difficult for a sentencing court given the many practical, legal and administrative factors causing a separation between Executive Branch fulfillment of its prosecutorial and other regulatory functions.

IV. THE PROPOSED GUIDELINES UNNECESSARILY LIMIT THE DISCRETION OF A SENTENCING JUDGE.

As the preceding discussion demonstrates, the structure of the draft Guidelines may well present situations where the total monetary sanction is too high or too low in view of the overall needs of the sentencing process. In such situations the only discretion reserved to the court is the flexibility within the Guideline range and, as a final resort, departure. Departures will, however, be difficult given the many specific findings by the Commission in areas where departures may be sought. In past testimony before the Commission we have argued for a more generalized reservation of judicial discretion in the sentencing process. We will not repeat these general arguments here.

The draft Guidelines appear to assume that reservation of additional discretion would inhibit the need for uniformity and contribute to sentencing disparity. While the legislative history of the 1984 Act clearly demonstrates Congress' concern about disparate sentences and lack of uniformity, it is not clear that Congress perceived this in the area of organizational sanctions. Congress appears to have been most concerned about disparity in incarcerative sentences for individuals. The Commission's data base is too small a sample to draw any conclusions about uniformity in organizational sentencing based on past experience. Additionally, many of the factors which contributed to disparity in sentencing of individuals in the past are arguably not present for organizational defendants. Congress expressed concern that offender characteristics such as age, family ties, education and economic status contributed to disproportionally low sentences for affluent and white collar offenders. These same considerations would not bear on organizational sanctions and to the contrary might be appropriate considerations for a judge at the time of sentencing.

While we would urge the Commission not to adopt a deterrent based philosophical approach towards organizational sanctions, considerations of deterrence are relevant. As the Commission has recognized, deterrence of organizational wrongdoing is a problematic area. Economic disincentives, fear of judicial intervention and the realities of the business world dictate that organizations will perceive the negative consequences of criminal conviction. The level of punishment must be high enough to make sure that this risk is a great enough disincentive to the potential economic gains from disregarding criminal laws.

The draft Guidelines require judges to make complicated decisions about value and other components of loss as well as the imponderables of the likelihood of detection and expense of prosecution. While the judge has a weighty task in making these determinations, he has little discretion in applying them. Deterrence may be a more subjective consideration when dealing with organizations. The reservation of additional judicial discretion will permit judges to consider not only the nature of the loss and the criminality but also any unique factors bearing on the organization itself.

The reservation of this discretion is especially important given the ever-increasing number of prosecutions involving major organizations. The current round of investigations of the securities industry, stepped-up environmental enforcement and the rapid expansion of RICO prosecutions into areas traditionally reserved for business regulation may herald a new era of criminal prosecutions of large national corporations. For example, recent press accounts have indicated that a RICO prosecution of a nationally known financial entity is under active consideration. These same accounts have indicated that the RICO forfeitures could be substantial. Should such a prosecution be brought and result in conviction, the sentencing judge should be free to consider the variety of factors at play in such a complicated case free of any stringent restraints in the form of organizational guidelines.

While cases against major corporations will in all probability continue to constitute a relatively small percentage of organizational indictments, the effect on the economy and other national interests may be important enough to warrant a reservation of judicial discretion for such cases. Additionally, many more run-of-the-mill organizational cases will present unique factors that may call for a flexible utilization of non-monetary and monetary sanctions. We urge the Commission to provide this flexibility to the sentencing court in the Guidelines.

V. THE COMMISSION'S USE OF A MULTIPLIER FOR FINES WILL RESULT IN DISPROPORTIONALLY HIGH FINES IN RELATIONSHIP TO SOME CRIMES COMMITTED.

The ABA endorses the concept of enhanced fines to be levied as a sentencing alternative against organizations convicted of crime but, because of their organizational status, immune from incarceration. Past practice has not provided for sufficiently high fines given the scope and magnitude of many organizational crimes. We do not, however, favor fines that exceed the greater of the pecuniary gain derived or the pecuniary loss caused by the organization's wrongful acts.

The ABA's Standards do not recommend fines geared to multiples of the gain or loss, nor do they provide for *in terrorem* treble damage penalties. While restitution may be used under the Standards as a supplement to a special fine, there should be no further enhancements. We believe that this provides a realistic and enforceable sentencing alternative that will serve the ends of deterrence and punishment.

Our disagreement with the draft Guidelines arises out of our belief that excessive penalty levels may, in the long run, prove counter-productive. History has shown us that prosecutors and courts alike are reluctant to seek and impose excessive penalties. The realities of plea bargaining and prosecutorial decisions may mitigate against fully charging offenses in order to avoid disproportionally high fines. Additionally, the absence of a multiplier or other enhancement will ensure that criminal fines are not passed on to consumers, employees or shareholders in a way that is disproportionate to their assumed risk. Finally, we do not believe that this policy turns its back on the seriousness of organizational wrongdoing. It does not merely call for a slap on the wrist. Given the fine levels established by the Sentencing Reform Act pecuniary gain or loss can indeed be a substantial sanction. Additionally the fine can be coupled with other corporate sanctions including proactive intervention in the corporation's affairs which potentially will have a far more deterrent effect on corporate wrongdoing.

Part of our position in this area is derived from the fact that convictions on criminal charges will be rare in areas that do not contain a substantial risk of civil liability. Where adequate civil remedies exists, they should be relied on as the appropriate monetary sanction with criminal fines serving only a more limited deterrent and punishment function. Given that the real cost of corporate fines may be passed on to consumers and employees, there is little reason to compound potential liabilities once the deterrent threat of the law is adequately established. Additionally, excessive fines carry the potential that corporations which are motivated by only economic considerations will have a strong incentive to settle unfounded charges with the prosecutor in order to avoid indictment and exposure to excessive fines.

VI. THE COMMISSION SHOULD ISSUE SPECIFIC GUIDELINES ON PLEA BARGAINING REGARDING ORGANIZATIONAL SANCTIONS.

The Commission's policy on plea bargaining is set out in Chapter Six of the Federal Sentencing Guidelines and is addressed primarily to the concerns effecting plea bargaining with individual defendants. There are unique concerns regarding plea bargaining in the organizational context that warrant special consideration by the Commission.

First is a recognition of the unique interests at stake in the plea bargaining process when organizations as opposed to individuals are involved. As the Commission's data reflects, in most cases individuals are indicted along with corporate defendants. When an officer or official of a corporation is indicted there is a strong tendency to strike any plea bargain which will result in the dismissal of the individual's charges. As a result the culpability of or punishment to the corporation may well take a back seat to these considerations.

Additionally, a corporation may have a whole range of other considerations which normally would not invade the plea bargaining process. For example, the current level of profitability or corporate reserves may make possible financial settlements and plea agreements where the normal punishment effects of a conviction are viewed as less substantial. The Commission has looked to the flexible approach as applied by the Federal Trade Commission and SEC as a model for its approach to organizational sanctions. Both of these agencies rely heavily upon consent decrees in resolving such matters. They recognize that admissions of wrongdoing may have a particularly profound effect on organizations that normally would not apply to individuals. The plea bargaining process should recognize this past experience and provide flexibility in entering into consent decree type settlements.

White collar defense practitioners have long emphasized the plea bargaining process as a significant component of their practice. The complexity of dealing with a potential array of ancillary civil and administrative proceedings during an on-going criminal investigation or prosecution leads to complicated plea bargaining discussions. Potential sanctions of debarment from government contracting, administrative penalties and double or treble civil remedies must all be considered as part of the exposure of the client. It is frequently difficult to negotiate with a prosecuting attorney who may not have any information about or authority over the civil or administrative process. In the best situations there is a coordinated governmental effort that permits negotiation about these range of potential sanctions and remedies at the same time. The plea bargaining process should be flexible enough to permit these types of dispositions.

VII. THE DRAFT GUIDELINES MAY RESULT IN UNNECESSARILY COMPLICATED FACT-FINDING BY THE SENTENCING COURT.

The Guidelines contemplate that the district court will engage in substantial fact-finding. For example, in the case of private fraud governed by Section 8B2.1 the court must first consider base loss defined as the difference between the value paid and the value received by the victim. While the application notes provide that the loss need not be identified specifically but only "reasonably estimated" it does set out a potentially complicated formula for determination of value. For example, value received is defined as the worth of the product, services or investments to the victims as actually received, or if the transaction was not completed as intended by the offender. The application note suggests that in a securities case the base loss for securities fraud could be derived by comparing the actual with the fraudulently misrepresented return on investment. This latter standard might be particularly difficult to apply where the defrauded investor, although not a party to the fraud, had knowingly signed on for a too good to be true deal.

In any of these situations the court will be called upon to take evidence and make findings on value. This fact-finding could be potentially time consuming and result in mini trials. The court will also be called upon to make specific fact-findings regarding the offense of conviction. Finally, under Section 8B3.1 the appropriate offense multiple must be determined. In particular the provisions of Section 8B3.1(b) will require potentially difficult factual determinations about the overall difficulty of detecting and prosecuting the offense. Section 8B3.2 sets out factors to be considered.

We urge the Commission to anticipate the difficulty of these fact-finding issues and draft Guidelines that rely on more ascertainable and quantifiable variables.

VIII. THE GUIDELINES SHOULD ADDRESS ENFORCEMENT MECHANISMS.

In the draft Proposal on Standards for Organizational Probation by John C. Coffee, Jr., Richard Gruner and Christopher Stone a proposed Guideline Section 8D2.7 dealing with enforcement and an accompanying policy statement is included. This Guideline was not included in the draft Guidelines nor was a similar enforcement Guideline included. While a specific Guideline on enforcement may not be necessary the Commission should consider drafting commentary on its view of the appropriate role of the district court in enforcing probationary conditions. The degree of judicial intervention in the corporate process contemplated by the probationary provisions of the Guidelines will be hollow indeed if there is no enforcement mechanism. As the discussion materials recognize, traditional sanctions of revocation may have little meaning in the context of organizational sanctions. The Commission should address what it views as the appropriate remedy for a violation of a condition of probation.

Remarks of

Gary G. Lynch
Director
Division of Enforcement

United States Securities and Exchange Commission

Before the
United States Sentencing Commission

United States Courthouse
New York, New York

October 11, 1988

The views expressed herein are those of Gary G. Lynch and do not necessarily reflect the views of the Commission or other members of its staff.

STATEMENT OF
GARY G. LYNCH, DIRECTOR, DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
BEFORE THE UNITED STATES SENTENCING COMMISSION

OCTOBER 11, 1988

I am pleased that the Sentencing Commission has offered me the opportunity to comment on the draft guidelines for sentencing of organizations convicted of federal crimes. As a matter of policy, the Securities and Exchange Commission disclaims responsibility for any private publication or statement by any of its employees. The views expressed in this statement are my own, and do not necessarily reflect the views of the Commission or other members of its staff.

INTRODUCTION

The Sentencing Commission has accomplished a difficult task in developing the draft guidelines and discussion materials on sentencing standards for organizations. I believe that its efforts will be very successful in encouraging comment regarding the sentencing of organizations. The draft guidelines and other materials clearly reflect a major expenditure of thought and effort on the part of the Sentencing Commission's staff.

I do not pretend to be an expert on criminal sentencing. The Commission's mandate does not include the prosecution of criminal violations, and thus my professional experience better prepares me to comment on civil and administrative remedies rather than on criminal sanctions. However, while the Commission does not itself prosecute criminal violations of the federal securities laws, it does work very closely and cooperatively with the Department of Justice and various U.S. Attorney's offices on criminal prosecutions which they have initiated, and my role in this process has also shaped the views that I will express.

The Commission has authority under Section 21(d) of the Securities Exchange Act of 1934 to refer matters to the Department of Justice for possible criminal prosecution. In addition, the Commission has adopted rules concerning the granting of requests for access to its investigative files which facilitate cooperation with criminal law enforcement authorities. Criminal prosecutions resulting from such referrals and cooperation, and the penalties that may be imposed, are essential to the effective functioning of the three-tier system of criminal, civil and administrative enforcement established by Congress in the federal securities laws. Thus, I believe that if guidelines are to be adopted for sentencing organizations convicted of securities crime, the guidelines should provide for meaningful penalties that add substantially to the array of relief and measures that can be imposed on organizations through civil and administrative sanctions.

The draft guidelines appear to embody an essentially economic approach to criminal sanctioning. Restitution, forfeitures and monetary fines are emphasized as appropriate and adequate sanctions in the majority of cases, combined with probation and notice to victims where necessary. The determination of an appropriate monetary sanction is based on the actual economic loss caused by a violation. This "base loss" amount is subject to a multiplier, which is intended to reflect the difficulty associated with detecting and prosecuting the offender. In addition, the actual enforcement costs can be added when determining a sanction. The draft guidelines require the coordination of civil and criminal penalties, and permit the reduction of criminal sanctions by amounts recovered in civil proceedings against the violators for the same underlying conduct.

In this statement, I would like to address some of the assumptions underlying the guidelines. Because I have substantial reservations about the approach adopted in the guidelines, I will reserve comment on specific standards in the draft. Instead, I will address the broader issues as to whether the guidelines are likely to lead to appropriate sentences, and whether they will unduly restrict flexibility to craft sanctions that are appropriate to the circumstances of crimes committed by organizations.

DISCUSSION

At the most general level, the draft guidelines reflect a purely economic view of the motivations for engaging in acts that constitute criminal conduct, and of the way the law should address such conduct. This economic approach appears to be based upon several premises. Chief among these is that business organizations, which cannot be imprisoned, are primarily motivated by profits and losses. The guidelines therefore emphasize monetary sanctions as having the "most direct impact on a business firm's fundamental interest." In addition, a focus on economic considerations permits a more or less precise determination of penalties, thereby providing organizations with "measured incentives for assuring their compliance with federal law."

While I agree that the payment of money will in most instances provide the most effective criminal sanction against organizations, I believe that a purely economic approach in arriving at the amount of money to be paid will not meet the most important goals of sentencing. In particular, I do not believe that adoption of the guidelines would permit sufficient flexibility for the imposition of sanctions that would constitute just punishment under the circumstances of each case, or that would deter violations by organizations.

A system of criminal law must provide for penalties that are just and proportional to the gravity of prohibited acts, and that will serve as a deterrent to criminal violations by others. The draft guidelines proceed on the assumption that "[t]he offense loss measures society's interest in controlling the criminal conduct," and thus provides the basic measure for determining a sentence. However, this assumption takes a too narrow view of society's interests as they relate to criminal behavior.

With respect to violations of the securities laws, the civil remedies available to the Commission and to private litigants will often be sufficient to ensure that a violator will not enjoy the fruits of illegal behavior. But beyond recovery of losses, society also has an interest in ensuring that crimes do not recur, and that wrongdoing is appropriately punished. Criminal prosecution for securities law violations provides a level of deterrence that cannot be obtained through civil or administrative sanctions alone, and demonstrates that justice will be done in response to such crimes.

The economic approach to sanctioning undervalues the fact that, at a fundamental level, some types of crime are more serious than others. Because the draft guidelines limit sanctions to a multiple of the actual or potential economic losses arising from particular violations, they thereby fail to reflect the view that some violations are inherently more or less serious than others, with the more serious violations posing greater dangers to society's interests. A corporation's violation of the prohibition against insider trading may result in more or less quantifiable losses to other market participants. But the societal costs of one instance of insider trading go beyond the losses to specific investors in that particular instance. Insider trading tends to undermine public confidence in the fairness and integrity of the nation's securities markets, and therefore causes a broader, and less readily quantifiable, injury to society. The proposed guidelines, however, will tend to treat all crimes as inherently equal -- differing only in the loss they cause in individual cases -- and will not uniformly place a greater sanction on the more serious violations. Thus the system would, at best, provide a skewed form of justice and deterrence.

While a system based on relative seriousness of offenses would involve subjective determinations of a sort that would be eliminated under the purely economic approach, such determinations may nevertheless be required in a system that adequately reflects the needs for just punishment and adequate deterrence.

I believe that the economic basis of the draft guidelines will fail to promote deterrence because it rests upon an inaccurate motivational explanation for violative conduct. There may be some individuals, acting on their own behalf or on behalf of business organizations, who make cold-blooded calculations of expectable gain and loss, and determine whether or not to commit crimes on the outcome of such calculations. A system of sanctions that relies upon a similar calculation to deprive those persons of the benefit of illegal acts, weighted according to the risk of detection, will tend to tilt the balance against violative conduct. But I think it is the rare individual or organization which determines to break the law by undertaking a purely rational consideration of probable consequences.

In many cases, securities law violators act out of simple unreflective greed. Sometimes they may act to hold on to a job, clients or business contacts. In some cases, they may even act from a desire to gain status with, or as a favor to, friends and colleagues. To the extent that the average individual engages in a calculation of risks and rewards, potential gains tend to be inflated and potential risks underestimated.

To reach potential violators, prosecutors and judges have to convey a stronger message: that the penalties for detection and conviction will not only eliminate any gains to the violator, but will be perceived as sufficiently abhorrent that no reasonable person would even undertake an economic analysis of the risks and rewards of the conduct. Since an individual violator can be imprisoned in addition to being required to pay fines or restitution, it is not unreasonable to expect corporate defendants, in appropriate cases, to pay monetary penalties that will have a deterrent effect equivalent to imprisonment.

I believe that the penalties generated by the draft guidelines will almost always tend to be too low for effective deterrence. While the draft guidelines are plainly intended to prevent excessive fines, the public perception of criminal sentencing tends to be that corporations and white collar criminals receive relatively light sanctions for their offenses. To the extent that a system of sanctions is to be developed, it is imperative that guidelines be crafted which will insure that penalties are sufficient to deter violations and to counter this public perception of undeserved leniency. In this regard, I am pleased to see that the guidelines specifically state that forfeitures required by the Racketeer Influenced and Corrupt Organizations Act (RICO) would not be affected by the guidelines.

The sentence to be imposed upon a corporation for crimes such as securities fraud would be determined under the guidelines by calculating the loss caused by the offense and increasing this amount by a base multiple of two. This multiple could be increased to three times the loss caused by the defendant in circumstances where the characteristics of the offense increased the difficulty of detection and prosecution. However, the guidelines contemplate that mitigating circumstances could be factored into the equation to reduce the multiple to one, thereby generating monetary sentences equal to the loss caused by the defendant. Even on the assumption that losses resulting from securities fraud will almost always exceed the gains to violators, a person considering the commission of a crime might well conclude that a sanction potentially limited to the amount of loss would constitute a risk which is reasonable to incur. Hence, even if I accepted the assumption that organizations intending to commit a violation make determinations in an analytical manner, I believe the penalties available under the guidelines will tend to be inadequate to deter violations.

This conclusion is reinforced by the provision in the guidelines for an offset for compensatory payments made by defendant corporations as a result of civil actions by federal agencies or private plaintiffs. To take insider trading violations as an example, the Commission has authority under the Insider Trading Sanctions Act of 1984 to seek civil penalties up to three times the profit gained or loss avoided by insider traders, a penalty that may be obtained over and above the disgorgement of profits that is available to the Commission in equity. Individual investors may in appropriate cases seek recovery of losses in private damages actions against insider traders. A reduction of criminal sanctions against insider traders by the amounts potentially available to the Commission and private litigants could easily result in the imposition of no sanction at all against a defendant organization. In many cases, the prospect of little or no sanction might influence criminal prosecutors to decline prosecution in cases that would be brought today.

The draft guidelines will also tend to be inadequate for the promotion of deterrence because judges will not be allowed to consider the size and nature of the violator in setting penalties. The draft guidelines "reject the use of an organization's size or financial performance as a principal measure of penalties," primarily because "large organizational size alone does not necessarily render an offense more harmful in terms of loss or detectability." The difficulty with this view is that a larger entity that can easily afford to pay a fine based upon a multiple of expected loss to others may not be deterred by a fine that would put a much smaller entity out of business. The largest entities will only be deterred by a standard that allows judges to consider differences in ability to pay in determining the appropriate sanction. Fairness may require specification of the maximum fine that may be imposed for a given violation, but this maximum should reflect a judgment about the seriousness of an offense and the level of deterrence reasonably likely to cause the largest potential violators to obey the law.

Having argued that the penalties generated under the guidelines will tend to be too light, I should also note that there may well be cases in which the computation might result in penalties that are too harsh. The proposed guidelines focus upon the violative conduct and the economic harm caused, but do not permit consideration of the type of organization which has been convicted. The imposition of the same penalty upon a general partnership, a limited partnership, a close corporation or a public company will have quite different results in terms of both whether the punishment is just and the deterrent effect of the punishment. A public company, for example, may be criminally liable for the acts of its agents. But in determining the penalty for a public company, the courts should consider a number of factors, such as whether the corporation profited from the wrongdoing, the level of involvement by its senior management, the likelihood that the conduct could have been detected by a vigilant and conscientious management, and the steps that were taken by the organization when the first scent of illegality reached senior management. While one could argue that the unfair application of penalties could be avoided through the exercise of prosecutorial discretion, the rigidity of the draft guidelines might force prosecutors or judges into an "all or nothing" decision that is obviously undesirable.

While the conceptual difficulties discussed above are my principal concerns, I believe that there are practical issues which are raised by the guidelines. Adoption of the guidelines would tend to intertwine criminal and civil cases in a way that would needlessly complicate both. The system of offsetting criminal penalties by potential recoveries in civil actions would make it in the interest of defendants to argue that all other actions against them should be resolved <u>prior</u> to the criminal action, to ensure that they receive the maximum benefit of any offsets. In addition, the intertwining of civil and criminal relief could further interfere with the handling of Commission civil actions, most of which are settled, because defendants would have an interest in tying the terms of their settlement negotiations to the progress of any criminal actions against them.

In sum, I believe that the guidelines, if adopted, would fail to provide just penalties, and would tend to result in penalties that would be inadequate for the deterrence of violative conduct. In addition, I believe that the guidelines would tend to tie criminal penalties to civil recoveries in a manner that may well interfere with the just and timely determination of both.

CONCLUSION

As I indicated at the outset, I believe that the Sentencing Commission has provided a useful and thought-provoking draft. I thank you again for providing me the opportunity to express my views, and I look forward to responding to any questions you may have concerning these comments.

Testimony of Commissioner Ronald A. Cass
United States International Trade Commission
before the
United States Sentencing Commission
Hearing on Organizational Sanctions
New York, New York
October 11, 1988

Let me begin by noting that my testimony today presents personal views and does not represent the official position of the U.S. International Trade Commission on organizational sentencing. Although the International Trade Commission does in effect decide whether penalties should be imposed on certain organizations for particular violations of law, and even recommends the penalty level and structure in some instances, we have not yet been given any mandate over criminal sentencing. If we receive such a mandate in the future, however, we certainly will look first to the actions this Commission chooses to take.

The Proposed Alternatives

The Sentencing Commission has before it two different proposals based on two somewhat different approaches to sentencing organizations. One, proposed in a discussion draft by the Commission's staff, advocates reliance on monetary penalties for organizations convicted of crime. This proposal contemplates no substantial use of non-monetary penalties other than assuring payment of such penalties when an organization is unable to clear its account immediately and instead is allowed to pay its bill "on time."

The alternative approach, proposed by Professors Coffee, Gruner, and Stone, advocates broader use of organizational probation. Under their proposal probation would be more generally available and would comprehend both an expanded set of regulatory tools and a broader purpose. Probation would, on this approach, include development of compliance plans, supervision of the organization by a judicially appointed monitor, institution of new management procedures, audits, and other measures. Its purpose would be not to assure payment of monetary penalties but to reform corporate organization and operation so as to prevent future criminal incidents.

I am without doubt much less fully versed in the details of these proposals than are other witnesses and the Members of the Sentencing Commission. Rather than exploit my comparative disadvantage in this regard, I will limit my testimony to more general discussion of the choice between the underlying approaches represented by these competing proposals (and, in more absolute terms, the propriety of each approach).

The Monetary Sanctions Approach

The staff approach in its basic conception is premised on four assumptions. This "Monetary Sanctions" approach first assumes that the organizations subject to criminal sentencing (outside the organized crime context) are profit-seeking organizations.

Second, the Monetary Sanctions approach assumes that the prospect of financial rewards principally governs the conduct of such organizations. Two critical inferences follow from this assumption. One is that the same basic incentives generally will inform both criminal behavior and socially desirable behavior in profit-seeking organizations; that is, the same interest in profits that leads to new products and efficiency-driven cost reductions also leads to violations of regulatory standards and antitrust laws. A related inference the Monetary Sanctions draws is that preventing and correcting socially undesirable behavior by these organizations depends on changing the monetary returns to the organizations from legal and criminal conduct.

Third, this approach assumes that the ideal change in monetary returns to the organizations will be effected by making the organizations bear the costs that criminal activity imposes on others. This fully accounts for the harm attributable to the criminal activity but does not induce the organization to avoid desirable activities, such as legal efficiency-enhancing forms of cost reduction. I find it more useful to speak in terms of "internalizing" the harmful effects of organizational actions than in terms of a "loss-based" system of punishment, but I believe the essential point is the same.

Finally, the Monetary Sanctions approach assumes that forcing organizations to internalize the social costs of their actions best is accomplished by a system that incorporates three critical features. For one, the system's focus should be attempting to dissuade a _class_ of organizations from engaging in criminal activity. A second feature, derivative of the first, is that this focus requires estimation not simply of the actual harm engendered by a particular criminal act but of the harm from a class of acts and the likelihood of sentences being imposed on members of the class of organizations committing such acts. The third feature of this optimal internalization approach is what might be called a principal of parsimony or minimal intrusion: as the organizations subject to sentencing will differ in various details and the exact mechanisms best suited to control their operations will differ accordingly, the government should attempt only to set the sanction faced by the organization and should not attempt to prescribe the means by which the organization should determine its response. Thus, the Monetary Sanctions approach concentrates on setting the money penalty at the appropriate level but eschews any effort to dictate the optimal organizational structure for crime avoidance.

Some of these assumptions are subject to empirical verification, and so far as possible those assumptions appear consistent with the empirical evidence. Other assumptions are not subject to verification, and must be accepted or rejected on their analytical coherence and intuitive appeal. On this ground, too, the Monetary Sanctions approach appears well-founded. The application of this approach is to corporate enterprises that risk violations of regulatory constraints or similar laws protecting property rights. The goals for criminal sentencing in this context should be to design sanctions that are appropriate to the class of defendants and actions, that neither overdeter nor underdeter the activity, that avoid costly efforts to tailor sanctions to each individual case, and that confront business competitors with similar costs for similar conduct. The Monetary Sanctions approach seems generally in accord with these goals. It may not fit the crime or the criminal perfectly in every case, but it offers a range of "off-the-rack" choices that at reasonable cost to society should approximate the tailor-made result.

I believe that the basis for this proposal and its relationship to the Sentencing Commission's charge are well laid out in the preface to the proposal and in the background papers by Commission staff. The remainder of my testimony will address the alternative approach proposed by Professors Coffee, Gruner, and Stone. For convenience, I will refer to their approach as the "Corporate Governance" approach to organizational sentencing.

The Corporate Governance Approach

The Corporate Governance approach also envisions the general use of monetary sanctions for organizational defendants, but grants a much-expanded role to probation as a complement to monetary sanctions. In proposing their Corporate Governance approach, the professors premise their suggestion largely on perceived deficiencies with the Monetary Sanctions approach. They claim four deficiencies with the Monetary Sanctions approach, each of which becomes a basis for preferring the Corporate Governance approach.

Professors Coffee, Gruner, and Stone argue first that in many cases it will not be possible to properly calibrate the monetary sanction so as to provide optimal deterrence. Second, they state that optimal organizational deterrence will not necessarily deter the organizations' individual officers and employees from engaging in criminal activity, even when it is "in the organization's rational interest (narrowly conceived) to do so." Third, the professors urge that use of probation to assure organizational restructuring is less costly, relative to the social benefits, than exclusive reliance on monetary sanctions. Fourth, they claim that a system built on monetary sanctions risks losing public confidence, assuming that public confidence is coincident with a sentencing system that inflicts pain (financial or otherwise) beyond the level any would-be criminal willingly would tolerate.

I believe that each of these objections is misconceived and that the resulting proposal should be viewed with considerable skepticism. Most of the objections are informed by premises that have two serious analytical difficulties. One is that the critics of the Monetary Sanctions approach fail systematically to compare the Corporate Governance proposal with the Monetary Sanctions proposal; having identified what they believe is a deficiency in the latter, the professors presume that the objection provides support for the former. That would only be true, however, if the objection were not equally (or more) applicable to the Corporate Governance proposal. In general, I believe that the objections to the Monetary Sanctions approach apply with at least equal force to the Corporate Governance proposal. A second problem with the Corporate Governance approach is that it builds on a fundamental misconception of appropriate sentencing goals.

The comparative problem is a general, if less critical, difficulty. Professors Coffee, Gruner, and Stone at least implicitly, and at times explicitly, must be taken as saying that problems they have identified with the Monetary Sanctions proposal do not similarly affect their own proposal. I do not believe that proposition well taken.

The professors' first objection to the Monetary Sanctions proposal is exemplary. The complaint is that insufficient information is known about the harm from particular classes of criminal conduct and/or about the frequency of conviction to allow a system of "optimal deterrence" to be built on the basis of monetary sanctions.

The predicate is arguable in degree but not in absolute terms. Of course, the state of knowledge of the magnitude of harm done by particular types of criminal conduct and of the relative frequencies of conviction (out of the total universe of offenders) is far from complete. In some areas, we may have enough information to allow estimates within some reasonable order of magnitude. In other areas, our knowledge certainly is sufficiently rudimentary -- because the number of cases in the system is small, because no reasonably firm basis exists for assessing the universe of offenses, because evidence of harm (for example, to the environment) is unlikely to be clear, or because the valuation of the harm is problematic -- to provide a base only for the broadest and least confident estimates of the relevant parameter values.

The question properly put, however, is the relation between the professors' predicate and their conclusion. Given substantial incompleteness of the information base, is a relatively intrusive form of regulatory probation likely to result in more optimal deterrence than monetary sanctions? That is, in cases where it is difficult to estimate precisely the optimal monetary sanction, how much easier is it to identify the ideal organizational structure? One would suspect that whenever the proper monetary sanction cannot be accurately calculated, design of the optimal intrusive probation will prove equally elusive.

Similarly, the professors complain that a monetary sanctions approach may result in insufficient deterrence. That is, of course, true. Almost any sentencing system may result in insufficient deterrence. The Monetary Sanctions proposal endeavors to avoid both insufficient deterrence and overdeterrence, but it is unknowable -- certainly ex ante and probably ex post as well -- whether those efforts have succeeded.

As with the complaint over information deficiencies, however, the Corporate Governance proposal should not automatically be preferred on deterrence grounds. Among other things, the very nature of probation, which is a temporary period of governmental supervision, makes it an unlikely mechanism for deterrence. Probation may deter the organizational offender from similar violations while the probation is in effect, but it is not obvious how it would deter the offender once the probationary period has expired.

Nor is it clear that the threat of probation will deter any other company facing similar incentives to engage in misconduct except so far as the probation plainly imposes real costs on the organization, as, for example, if it mandated use of manifestly inefficient organizational structures. Yet, the professors defend the form of probation they recommend as providing incentives to more efficient organizational structures, not less, which makes it peculiarly hard to see why they believe it has great deterrent value.

While the proper comparison is of particular types and levels of each sanction, monetary sanctions generally would seem preferable to probation on deterrence grounds. Unlike probation, monetary sanctions plainly constitute a penalty and also offer universal coverage, presenting the entire class of potential offenders with an incentive to avoid the activity at issue.

The same problem of comparison also confronts the cost-effectiveness claim for the Corporate Governance approach. Contrary to the implication in the professors' paper, probation is far from costless. Anyone who has watched the exercise of judicial control over an enterprise, whether exercised directly by a judge or indirectly by a master, will recognize the magnitude of the cost that often accompanies such supervision. Not only are real resources used to supervise and regulate, but these costs are likely to be borne by the government as well as the organization. A natural consequence of this is that the true incidence of such costs will include their imposition indirectly on taxpayers, consumers, and workers. Monetary sanctions, both in form and in actual incidence, are more likely to constitute a redistribution of resources from the offender to the government or victim, and thus are less likely to impose net social costs.

The comparative disadvantage of probation from the standpoint of social costs has importance beyond the first-order cost-benefit calculus. To the extent the costs of probation fall on the government, probation seems perversely to penalize taxpayers at large. Insofar as probation imposes costs on the offending organization that would not be present under optimal monetary deterrence -- as, again, where it induced the substitution of less efficient organizational structure or production processes -- the competitiveness of the organization may be harmed in world markets. In a world of less than fully mobile factors of production, it is not certain a priori just how organizations would adapt to forced inefficiencies of this sort, but it is a concern that this Commission should at least take into account.

In this regard, it is worth noting that, although the universe of criminal sanctions actually imposed on organizations is relatively small, the universe of potential organizational violations of federal law is extraordinarily large. I believe that a very sizeable share of federal regulations are enforceable through criminal penalties; and one need only glance at the Code of Federal Regulations to get a sense of how many there are. Nor does the Corporate Governance proposal's circumscription of probation to criminal violations that implicate health or safety concerns limit organizations' exposure. Nearly every governmental regulation has been argued to fall within this rubric. Likewise, the restriction of probation to instances in which managerial delicts contributed to the criminal violation is a limitation of lilliputian proportions: it will be hard indeed to find a case in which that cannot be said to be true.

In raising concerns over the efficiency implications that follow if probation induces changes in institutional structures or operations, I should note that my use of the concept of efficiency may diverge from the use Professors Coffee, Gruner, and Stone would prefer. This difference brings me to the second problem I have with the professors' proposal, the problem of sentencing goals.

Let me illustrate the problem by positing two possible purposes for probation of the sort contemplated by the Corporate Governance approach. First, probation could assist organizations in identifying optimal structures for cost-efficient operation once the organization is forced to internalize the full social costs of its actions. Second, probation could command structural adjustments that are not optimally suited to that goal but instead are designed to serve a different goal. Probation intended for either purpose is problematic, but for quite disparate reasons.

The first use of probation suffers from hubris. It necessarily implies not just that the world is a less than perfectly efficient place but that the judicial regulators who are charged with supervising the probationer can identify efficient management structures more effectively than can the offending organizations themselves (once confronted with optimal monetary sanctions). On its face, this premise seems to require that officers of the court know more about an organization's operations than the managers of that organization. The caveat that the Corporate Governance approach really leaves this decision to the probationer is misleading; the monitor must know whether to accept or reject the probationer's suggestion and must direct the probationer in a direction that the probationary organization would not otherwise take (else, why have probation at all?). I am deeply skeptical that judicial regulators will have a comparative advantage over the managers and members of particular in identifying efficient organizational structures for those organizations.

The alternative use of probation probably corresponds more closely with the intent of the Corporate Governance proposal. The vision is that probation will induce a change in structure that is efficient given a goal other than the optimal social cost-benefit calculation. The suggestion implicit in the professors' proposal is that it is not enough to have the corporate managers take account of the costs imposed on others (generally, persons who are not contractually linked to the corporation) by actions such as the use of fuels that generate more airborne pollution or chemicals that produce more toxic effluents or processes that increase noise or fire or radiation risks to residents of neighboring areas. The goal embraced by the Corporate Governance proposal, in fact if not in word, is total deterrence, not optimal deterrence.

The orientation toward deterrence regardless of its social cost provides the most plausible explanation for the second and fourth of the objections, noted above, that the professors raise to the Monetary Sanctions approach. They argue that, even when an organization faces a possible sanction that fully reflects the social costs of an act, individuals in the organization may still engage in the act. That, of course, is true. Even in the days of keel-hauling, scourging, and trial by ordeal, no criminal punishment system ever achieved total deterrence of crime. At the same time, surely that is not the purpose of criminal punishment, especially not for the sort of infractions of regulatory constraints at issue in organizational sentencing.

Similarly, the objection that reliance on monetary sanctions undermines the public's confidence in the criminal justice system must rest on a belief that the public expects total deterrence and will settle for no penalty that a defendant willingly would bear. I think this view both misstates the public's expectation and overestimates the public's knowledge of and reaction to sentences for the sort of criminals and criminal conduct at issue. Murder, rape, and bank robbery capture the public's attention quite a bit more readily than do regulatory violations or property rights infringement by corporate defendants. Even the hardest-core supporters of property rights are unlikely to want such violations punished by whatever draconian measures are necessary to assure that no violations occur.

Obviously, Professors Coffee et al. have not explicitly embraced a goal of total deterrence and probably would not do so. Their objections to the Monetary Sanctions approach and preference for expanded use of regulatory probation, however, can not readily be understood apart from such a goal. If the professors do not embrace deterrence at a cost above that equal to the social harm prevented by criminal enforcement expenditures --that is, deterrence that moves beyond optimal toward total deterrence -- their discussion at the least reflects some confusion of these concepts.

Indeed, even their use of numerical examples, as in the first footnote to their paper, suggests a confusion of total and optimal deterrence. The example in that footnote is intended to support the professors' contention that a monetary sanction designed to force an organization to internalize the non-private component of social cost imposed by the crime (the cost to others, outside the organization) will underdeter because it will not afford the organization an incentive to invest in crime control. The contention is incorrect (or else it is an unsupported assertion that organizations that violate federal laws are systematically less efficient than other enterprises). The footnote, reflecting this error and also a failure to separate marginal from total investment in crime prevention, suggests the ideal monetary penalty to be a figure that is fully twenty percent higher than is necessary to offset the social cost of the crime under the facts given in the professors' hypothetical example. In other words, the example wrongly suggests that monetary sanctions, conceived as they are in the staff's discussion draft, will underdeter because the Corporate Governance proponents either misconceive the calculation of private and social costs or believe that sanctions should be set above the level necessary to offset the social costs that, but for the criminal sanctions, are not apt to be considered by the organizational actors. Absent some special insight into the peculiar nature of organizations that run afoul of legal constraints, there is no basis for belief that the law should give organizations incentives to avoid socially beneficial behavior by adding to the marginal external costs of criminal activity the costs that profit-seeking organizations are most likely already to take into account.

Conclusion

The staff's proposal appears to build logically on accepted goals of criminal punishment a system that is appropriately conceived to sentence organizational defendants without over- or under-investment of social resources. Of course, which sentencing system will work better to advance a given set of normative precepts is an empirical question, albeit one for which conclusive data are most unlikely ever to be gathered. In the absence of such data, however, the proposal built on a more solid analytical base is, ceteris paribus, more likely to serve the posited ends. The analytical flaws in the Corporate Governance approach, thus, suggest that it is not preferable to the more cogently presented Monetary Sanctions proposal.

10/7/88 Draft

Statement of Professor John C. Coffee, Jr.
Adolf A. Berle Professor of Law
Columbia University Law School
October 11, 1988
United States Sentencing Commission Hearing
United States Courthouse, Foley Square
New York, New York

As someone who has spent a long time toiling in the particular vineyard under examination today -- both as the draftsman of the ABA Sentencing Standards and as a member of a National Academy of Sciences Panel that investigated the empirical research on sentencing guidelines -- I am afraid that my basic message is that the topic of organizational sanctions is considerably more complex than the Staff's "Discussion Draft" appears to recognize. At bottom, the Discussion Draft is an object lesson in what happens when one takes a narrow, one-dimensional view of the criminal law -- a view that ignores the criminal law's multiple purposes and its deep interconnections with public morality. In my comments today, I intend to focus today principally on the Staff's proposed guidelines for fines, and not to argue the case further (except in response to questions) for the probation draft that I and my colleagues, Richard Gruner and Christopher Stone, have prepared. Let me begin with a brief overview of my criticisms, which I will group under four headings, which move on a continuum from the specific to the more general:

(1) The Discussion Draft's proposed guidelines for fines cannot be implemented under current law without imposing unacceptable procedural and logistical burdens on the prosecution and probation staff -- burdens which the current procedural law of sentencing does not afford them any means of satisfying. Put simply, under these proposed guidelines, the

sentencing process becomes so complicated that the tail begins to wag the dog. The net result is to create a serious disincentive to the prosecution of organizations (as opposed to individuals). If organizational liability is necessary to ensure that the organization monitors its agents (as the Discussion Draft properly argues), then the Staff's proposals frustrate their own purposes.

(2) As advanced in these guidelines, the concept of "offense loss," undercounts the true social loss from many crimes, particularly those involving public integrity offenses, such as bribery or obstruction of justice. By focusing solely on the property loss (and administrative and enforcement costs) caused by the crime, these guidelines ignore the ripple effect from public corruption (or other crimes that create public distrust or cynicism). In addition, the guidelines trivialize many regulatory reporting offenses by ignoring the injuries that violations of reporting regulations cause for the public. Symptomatic of the Discussion Draft's apparent view that many felonies committed by organizations cause little harm is the absurdly low level of minimum penalties they establish (sometimes the "base loss" is as low as $500). Viewed ex ante, the effect of such low penalties is not only to under-deter, but also to discourage prosecutors from allocating scarce resources to the prosecution of such organizational crimes. I shall try to illustrate this point by walking some recent or possible future corporate prosecutions (Hertz, E.F. Hutton, Allied Chemical, Drexel Burnham and the current defense procurement scandal) through the guidelines to show the de minimis sanctions that could result under them.

(3) Under-deterrence also results from the presumption established by these guidelines that the applicable offense multiplier should generally be either 2.0 or 2.5. Under the basic methodology of the Discussion Draft, which multiplies the "offense loss" by an "offense multiple" that in theory compensates for the fact that the probability of apprehension and conviction inevitably falls below 100%, everything depends on whether the offense multiple bears a close relationship with the actual probability of apprehension and conviction. Although this theory is, itself, debatable, the attempt to translate it into reality lacks any foundation in reliable data or research. In particular, the use of presumptive offense multipliers of 2.0 and 2.5, respectively, for most organizational crimes flies in the face of much evidence that most "white collar" crimes are hard to detect and have low probabilities of apprehension. Such multipliers mean that if the likelihood of apprehension and conviction is below 50% and 40%, respectively, the offender will not be deterred even within the four corners of the theoretical assumptions employed. Consider such crimes as insider trading and tax fraud, where the likelihood of apprehension is generally believed to be far lower than 40%. However powerful the model may be, any model is vulnerable to the familiar "GIGO effect" -- namely, "Garbage, In; Garbage Out". If we put garbage into our calculations by engaging in the fictional assumption that there is a 40%-50% apprehension rate, we get garbage out.

(4) Inevitably, in setting penalties, we must balance two types of errors: (1) the danger that one class of offenders will be over-deterred by excessive penalties and so will desist from socially

desirable activity, and (2) the danger that crime victims will suffer from inadequate deterrence. The animating principle behind these guidelines appears to be the view that organizations are overdeterred today and so penalty levels should be lowered in their case. I am unaware of any substantial body of evidence supporting this view. Given our lack of knowledge and the inevitable imprecision in this area of "soft" social science research, it is necessary to choose between these two legitimate concerns and assign a priority to one. I believe the victim's interests deserve that priority. Normatively, the injuries to victims from under-deterrence merits greater concern than the injuries to perpetrators who are over-deterred.

I. <u>The Feasibility of Social Loss Determination at Sentencing</u>

The first question to ask about any set of proposed guidelines is whether they will work in practice. Can they be feasibly implemented. My answer for the guidelines is "No." The principal procedural flaw in the Staff's approach to fines is that it combines very low minimum penalties with an attempt to compute the actual harm or loss caused by the crime. Such an approach would be more defensible (although still debatable) if it were as simple to compute the actual loss at sentencing as the Staff seems to believe it is. Although the Staff's draft asserts that its "rules do not require absolute precision, and are satisfied by reasonable estimates based on the information available to the court at the time of sentencing" (p. 8.3), no serious attempt is made in the Draft to examine any of the following: (a) the information base available to the court at sentencing, (b) the problems inherent in acquiring reliable information at this stage of the criminal process; or (c) the major legal issue of the burden of proof. Indeed, more interested in economics than law, the Staff seems simply to have ignored these issues. In its most specific statement, the Draft says only (at p. 8.9) that:

> "Although the guidelines for monetary sanctions of necessity involve dollar amounts, it is not intended that organizational sentencing procedures be equivalent to a civil damages trial. Like all other criminal sentencing factors, offense loss may be based on any reliable information. See generally, 18 U.S.C. §3661; Fed. R. Crim. P. 32."

Put simply, this is a fast shuffle. It confuses the issue of the admissibility of information (where sentencing law is very relaxed and the rules of evidence do not apply) with the issue of the burden that the government must satisfy before information may be relied upon for purposes of determining the applicable sentencing guideline. On this latter question, recent developments have clearly changed the pre-existing law. The majority view now appears to be that the government must satisfy the preponderance of evidence standard with respect to disputed allegations in the presentence report before such information may be relied upon to determine the guideline range. See <u>United States v. Lee</u>, 818 F.2d 1052 (2d Cir. 1987); <u>McMillan v. Pennsylvania</u>, 106 S.Ct. 2411, 2419-20 (1986). Indeed, some cases have gone further and required the government to satisfy a "clear and convincing" evidence standard. <u>United States v. Fatico</u>, 603 F.2d 1053, 1057 & n.9 (2d Cir. 1979); <u>United States v. Johnson</u>, 682 F.Supp. 1033, 1035 (W.D. Mo. 1988); <u>United States v. Cox</u>, 556 F.Supp. 812, 814 (W.D. Mo. 1983). See also Note, <u>A Proposal to Ensure Accuracy in Presentence Investigation Reports</u>, 91 Yale L.J. 1225, 1245 n. 117 (1982). Either way, the burden for the prosecution is enormous. For example, take the recent prosecution of Hertz for falsifying hundreds of insurance appraisal reports in order to defraud customers whose rented cars suffered damage in accidents or collisions. Alternatively, consider the vast multitude of persons injured by Allied Chemical's actions in dumping the toxic chemical, kepone, into the Chesapeake Bay. If the government has the burden of proof and there are potentially 1,000 or more victims, it simply will not do to engage in ballpark estimates (as the Draft seems to believe is permissible). Predictably, defense counsel will fight zealously and demand that the government submit proof of injury.

Worse yet, the government must fight with its hands tied behind its back, because no procedures exist by which it can obtain discovery. Following indictment, grand jury process is no longer available. Nor may the prosecution then subpoena evidence. See Fed. R. Crim. P 17(c). To be sure, the court may subpoena witnesses to a sentencing hearing. See, e.g., United States v. Fatico, 603 F.2d 1053 (2d Cir. 1979). But, this technique is hardly feasible when there is a multitude of injured victims.

Basically, there is no mechanism for discovery because the traditional criminal process contemplated that the prosecution had gathered all its evidence by the time it brought the indictment. This may well be an out-of-date assumption, but the fact that a feasible mechanism for discovery is lacking cannot be ignored. To do so is to "assume a can opener" and disdain the realities of actual sentencing practice.

The actual practice today is that the Probation Service (not the U.S. Attorney) prepares the presentence report, and this requirement is mandatory. See, e.g., U.S. v. Weichert, 836 F.2d 769, 771-72 (2d Cir.

1988). Victims may, of course, approach the Probation Service, which is expected to prepare a victim impact statement in its report. Without intending to criticize the Federal Probation Service, I must observe that probation officers are ill-equipped to perform the role of fact-gathering in a large case involving multiple victims. Given their lack of expertise at damage computation and their limited resources, loss determination will be a "hit or miss" affair, with many victims never coming forward. Indeed, this has always been the experience in class actions where, even when there is a large settlement fund, many eligible class members never come forward to collect. Apathy is a fact of life, and, as a result, undercounting of the social loss is predictable.

Finally, one cannot ignore the motivations and incentives of prosecutors, themselves. They have never been interested in sentencing, and participate at this stage only sporadically and sometimes indifferently -- frankly because the glory and excitement of the job lies elsewhere. In this light, federal prosecutors are here being asked to assume a difficult burden that they are likely to shirk. When coupled with a constitutional burden on the government to prove the loss by at least a preponderance of the evidence standard, the use of the victims' loss as the principal determinant of the sentence will produce under-deterrence.

What response to this problem of under-deterrence is therefore desirable? I would answer that high minimum penalties are necessary. Whether the threshold for serious felonies should begin at $250,000 or higher is debatable, but the role of the victim's loss should be restricted to justifying a monetary sanction above a high minimum threshold. In effect, the victims' loss should be used to establish the ceiling (after multiplication by an offense multiplier), not the floor.

II. Defining the Social Harm

Whatever the fact-finding procedures employed, under-deterrence will still result if the injury to victims is defined too narrowly. Throughout the Staff's proposals on fines, an overly narrow definition of the loss is recurrently evident. The most obvious example is that all offense guidelines are keyed exclusively to property loss and ignore the impact of public corruption on society generally. Indeed, the guidelines explicitly state that "[t]he use of commercial bribery, kickbacks, or other corrupt methods to facilitate private fraud does not by itself require different rules of offense loss because these methods simply produce a sharing of gains between joint offenders..." (p. 8.13). A similar rule is stated for governmental fraud.[1]

Thus, under the Staff's guidelines, the following two cases, which both may be prosecuted under the mail fraud statute, are identical in terms of harm:

(1) Corporation X defrauds Corporation Y of $100,000 in a private commercial dispute by selling sub-standard goods, which it misidentifies.

(2) In order to win a $100,000 lawsuit with Corporation Y, Corporation X bribes a federal judge.

Although the Staff's guidelines suggest that bribery may affect the offense multiplier (because the crime is made less detectable), they do

1 "As with private fraud offenses, the corruption of governmental employees does not by itself require different loss rules..." (p. 8.17).

not recognize that there is any independent injury from the fact that a public official who has been corrupted. This insistence that the only legally cognizable losses are those that involve an injury to one's property betrays this Draft's moral myopia. In truth, the fact that it is a <u>public</u> official who has been corrupted constitutes the paramount injury. Moreover, it is also the more lasting injury because officials, once corrupted, tend to stay corrupted. The ripple effects of such a crime extend even further and involve an intangible injury to the public's confidence in the integrity of its government.

This refusal to accept such injuries (and the resulting public cynicism) as a legitimate concern of the criminal law evidences the moral blinders that this Draft appears to have been wearing. Clearly, however, Congress thinks differently, and numerous statutes (the Hobbs Act, the Travel Act, Obstruction of Justice, etc.) are aimed at official corruption and do not require a property loss. The Commission cannot be faithful to the Congressional intent if it ignores this special emphasis in federal law on official corruption.

The Staff proposal also exhibits a general tendency to trivialize and undercount other injuries that crime causes. This can best be seen by walking some recent and potential criminal prosecutions through the proposed guidelines:

a. <u>Defense Procurement Fraud</u>

Assume Corporation A bribes a Defense Department employee to obtain contract specification data on a proposed weapon system. As a result, Corporation A is able to submit a slightly lower bid. Assume further that no proof exists that its weapon system is inferior to that of its competitors, who, after all, never produced a prototype after losing the bid; nor is there any evidence that the national security was harmed. Under §8B2.2,(a)(2), the damages will therefore basically consist of the government's "increased cost to procure the product...." In theory, this guideline would also include the "administrative cost to the government and other participants of repeating or correcting the procurement action" but, if the contract has already been awarded and development is well underway, there is little likelihood that a weapon systems will be abandoned, or that several years' progress toward its completion will be discarded, simply because one side in effect cheated by beating the starting gun on the bidding process. Thus, the "base loss" under §8B2.2 could be as low as $5,000. Such a crime is not worth the prosecution's time to prosecute.

B. Insider Trading and Stock Parking

Corporation Z, a corporate bidder, engages in a "stock parking" offense whereby it fails to disclose until 10 days after it is required to do so that it has acquired in excess of 5% of a prospective target company's stock. By that point, it has acquired 20% (and probable voting control). This offense falls under §8B2.7 ("Regulatory Reporting Offenses"). Because the SEC incurs no real administrative cost (because the required disclosure is eventually made, if belatedly), the "base loss" could be as low as $500. (Drexel Burnham, take heart!). Of course, what is ignored here is that the interest group intended to be protected by the Williams Act is the investing public, who are never told, until it is too late, that a takeover is in progress.

C. Environmental pollution

Under §8B2.5, the difference between intentional misconduct (indeed, even conduct committed with a malicious desire to cause injury or death) and negligence results only in a $5,000 difference in the minimum fine (that is, the minimum fine is raised from $5,000 to $10,000 if the offense involved "an intentional knowing discharge"). Traditionally, the criminal law has focused on the offender's level of intent (or "mens rea") with an often single-minded intensity. Although this concern may be less pressing in the case of organizations, it still should not be ignored -- and, here, it is. Hence, one of the criminal law's most basic concerns is here trivialized.

D. Corporate Homicide

If the foregoing environmental violation were to result in a "foreseeable and substantial risk of serious bodily injury or death", §8B2.2 would become applicable and would authorize an upward departure from the guideline. But the amount of the authorized departure is again trivialized by a reference in the commentary to the monetary estimates of the value of human life "made by administrative agencies in establishing safety regulations" (p. 8.38). The problem with this approach is that it does not distinguish between the damages awarded for negligent injuries and those awarded for intentional injuries. Tort law has historically been keyed to the goal of compensation and has valued human life in terms of lost earnings. Of course, few of us would sell our lives so cheaply. Liability under the criminal law generally arises only for "knowing" or "reckless" violations -- i.e. intentional misconduct. Thus, it seems inappropriate to apply the damages awarded for negligent behavior to intentional misbehavior; indeed, tort law would typically award punitive damages in such a case. Use of "lost earnings" measures to establish the value of life (or bodily injury) exacerbates the problem of turning the criminal law into a pricing system. Carried to its reductio ad absurdum extreme, this approach would have created an incentive two decades ago for General Motors to pay the Mafia to assassinate Ralph Nader, because his life would have been valued only according to a mechanical actuarial calculation.

Justice Holmes once wrote that even a dog knows the difference between being kicked and being stepped upon. His point was to underscore the critical role of intent in the criminal law. It is exactly this role of intent that the Discussion Draft ignores.

Further, because the possible injury is to be discounted by the probability of the injury, the enhancement of the fine authorized under this section is very modest. As the commentary indicates, a violation that risked injury of between $500,000 and $1,000,000 could result in an increase of only from $500 to $1,000 in the fine. It is illusory to expect that probabilities can be calculated with such certainty. It is also a mistake to discount for the delay in the injury. (See p. 8.39) A death caused five years from today should for criminal law purposes be valued the same as a death caused tomorrow.

Thus, when the test in §8B5.2 of a "foreseeable and substantial risk of serious bodily injury" is satisfied (and I accept the phrasing of this test as sound), there should be a substantial minimum enhancement; in my personal opinion, it should be not less than $500,000. Attempts to estimate the precise percentage or to discount for the time value accomplish little of value and may undercut the moral authority of the criminal law.

III. The Offense Multiple

The Discussion Draft follows the model of deterrence theory developed by University of Chicago economist, Gary Becker, in multiplying the offense loss times a factor which is intended to compensate for the obvious fact that not all crimes are detected and prosecuted.[2] Thus, the statement in §8B3.1 that the base multiple should normally either be 2.0 or 2.5 is in effect an assertion that the probability of detection is normally either 50% of 40%, respectively.

Is there any empirical basis at all for this assertion? I doubt it. Certainly in the substantial effort undertaken by the National Academy of Sciences earlier in this decade to investigate the theory of deterrence, no such finding is reported. Moreover, there is contrary evidence for specific crimes. In her mammoth study of SEC investigations over the 25 year period from 1948 to 1972, Susan Shapiro reports that only 85 offenders, or 4 percent of the original sample, plead guilty or were convicted of securities violations. S. Shapiro, Wayward Capitalists. Yet, this 4% figure is based upon a denominator of those cases that were detected and investigated by the SEC, and thus it does not reflect those persons who escaped detection altogether.[3] In short, the rate of

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2 The Discussion Draft states this explicitly at p. 8.26 ("The basic concept of the multiple is to reflect the chances against an offender being detected and punished").

3 Shapiro found that 9% were determined by the agency not to be guilty; obviously, an even greater percentage could have been in fact innocent, and thus her data overstates in this regard.

apprehension and conviction for securities law violations could be well below 1%, and, if we accept Shapiro's findings, could be no higher than roughly 4%. Nor are securities fraud offenses more likely to escape detection than tax frauds, bribery offenses, or other covert forms of misbehavior in which the victim never learns that he or she has been injured. Such "silent crimes" (in Frank Zimring's phrase) almost certainly will not be deterred by a 2.0 or 2.5 offense multiple, nor necessarily by one ten times as high.

In this light, I would recommend that the offense multiple be scrapped. At most, it should be replaced by a section authorizing upward deviations in cases where the misbehavior was unusually difficult to detect. Of course, the corollary of this proposition is that high minimum penalties should replace the offense loss base. In summary, the guidelines should use high minimums coupled with a ceiling set at a reasonable multiple of the greater of the gain or loss.

IV. The Aims of the Criminal Law

The standard literature on the purpose of the criminal law is almost totally ignored by this Discussion Draft. Scholars as diverse as Henry Hart, Herbert Packer, Herbert Wechsler, Sanford Kadish, and Frank Zimring have agreed that the criminal must pursue multiple aims and not simply seek to deter the individual offender ("specific deterrence"). Most obviously, there is the goal of general deterrence, and, more subtly, there are the educational and socializing functions of the criminal law. These other goals of the criminal law are slighted when the criminal law is treated as simply a pricing system. From a general deterrent perspective, the problem with "pricing" the criminal behavior is that the "price" is set in terms of the mean defendant's incentives (that is, the expected cost must equal the expected gain from the offense, after discounting that gain by the likelihood of apprehension). Even if we assume that it were possible to determine the precise expected gain and the precise probability of apprehension for that mean offender, a "price" so determined would deter only that average offender (and also those offenders who perceived even less gain or a greater likelihood of apprehension). What happens to the offender who either perceives a greater expected gain or who estimates the odds of apprehension (accurately or inaccurately) as being more favorable to it? In short, if in real life there is a dispersion of potential offenders (some optimistic, some pessimistic; some more skilled at crime than others; some more risk averse than others), a pricing system that focuses only on the average offender will by definition under-deter the above-average offender. Similarly, it will not deter the less risk averse or the more optimistic offender. The point here is that, even within the four corners of deterrence theory, there is a need to employ substantial penalties that exceed the expected level necessary to deter the average potential offender. Instead, this Draft demonstrates an extreme solicitude about the dangers of over-deterrence. This concerns seems misplaced, because, so long as penalty levels are clearly indicated in advance, excessive penalties will seldom be imposed. The only potential social cost is that some socially desirable behavior will be deterred. No showing has been made that this is occurring. But, even if it is, the real answer here is to define the criminal law's contours more closely, and higher penalties will produce lobbying to this end.

From the perspective of the educational function of the criminal law, there is the even greater danger that a "pricing" approach to sentencing will undercut the moral authority of the criminal law by suggesting that "you may do the crime, if you are willing to pay the fine." A world of difference does and should exist between taxing a disfavored behavior and criminalizing it. We tax cigarettes, but outlaw drugs. Both are disincentives, but the criminal sanction carries a unique moral stigma. That stigma should not be overused, but, when properly used, it is society's most powerful force for influencing behavior and defining its operative moral code.

For these reasons, I do not believe that a sound system of organizational sanctions can rely solely on monetary penalties and certainly it cannot hope to operate with the mathematical precision here attempted. The message needs to be clearly communicated that there is no price that, when paid, entitles you to engage in the prohibited behavior.

Supplementary Testimony of Jonathan B. Baker

Before the United States Sentencing Commission

October 11, 1988

This supplementary testimony explains in detail why I encourage the Commission to adopt the Discussion Draft of Sentencing Guidelines and Policy Statements for Organizations: Proposed Chapter Eight for the Guidelines Manual[1] ("Discussion Draft"). In this document I address how the economic theory of optimal penalties works, why no scheme of sanctions will achieve complete deterrence, how the optimal penalties serve the social purposes of criminal sanctions, and why monetary sanctions are superior to non-monetary sanctions when organizations must be penalized.

I. The Economic Theory of Optimal Penalties

The primary strength of the Discussion Draft is that it incorporates the insights of the economic approach to determining optimal penalties.[2] The economic approach argues that a specific method of calculating sanctions will lead potential violators to make decisions that maximize social wealth. The resulting scheme of penalties provide the optimal level of deterrence according to the well defined economic criterion of efficiency.

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[1] United States Sentencing Commission, Discussion Draft of Sentencing Guidelines and Policy Statements for Organizations: Proposed Chapter Eight for the Guidelines Manual (July 1988).

[2] This theory was first articulated in Becker, Crime and Punishment: An Economic Approach, 76 J. Pol. Econ. 169 (1968).

In thinking about the consequences of penalties, it is important to recognize that any scheme of sanctions, whether based on optimal penalty theory or otherwise, will deter some or all violations. Deterrence arises because potential violators of the law recognize that their lawbreaking may be detected and prosecuted. Further, potential violators understand that if they are convicted they will be forced to pay a penalty.

The economic theory of optimal penalties provides a rationale for setting the penalty through a two step process.[3] First determine the penalty "base" as equal to the harm or loss a violation causes others.[4] Second, set the penalty at the level

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[3]Although the description of optimal penalties is couched in terms of a monetary metric, the formula does not in fact presume that only monetary sanctions will be employed. Non-monetary sanctions can be valued at a monetary equivalent for the purpose of ensuring that the penalty package in aggregate achieves the optimal level of deterrence.

[4]In the economic literature on optimal penalties, victim <u>loss</u> is the appropriate penalty base. If instead, the violator <u>gain</u> from unlawful activity is employed as the penalty base, and the multiple is derived as in the optimal penalty literature, potential violators will foresee no benefit from lawbreaking so will in principle be completely deterred.

This approach does not lead to an efficient allocation of resources, however, because firm expenditures on compliance with the law will be skewed. When victim injury appears likely to exceed violator gains, the penalty based on gains leads to underdeterrence. Potential lawbreakers will spend too little on ensuring compliance within their organizations. If instead gains appear likely to exceed injury, creating a situation of overdeterrence, potential lawbreakers will spend inefficiently high levels of resources on compliance.

The choice of penalty base likely matters less in practice than in theory. If violator gains are more readily calculated with the information available to a court than victim injury, the sentencing authority may find it necessary to use violator gains as an estimator of victim loss.

of the base times a multiple equal to one divided by the violator's anticipated probability of eventual detection and conviction.[5] This is precisely the framework adopted by the Discussion Draft to determine the appropriate criminal penalties for lawbreaking organizations.

This approach need not be applied with better than rough precision in order to achieve the full deterrence benefits of the economic approach. It is not necessary to identify either the loss or the penalty with more than a rough approximation if courts applying the methodology do not systematically overestimate or underestimate these figures across all violations. So long as a potential violator recognizes that any penalty that may ultimately be applied will be set according to a process that will on average yield the optimal amount, the potential violator will be deterred just as he would have been were the harm and the multiple estimated with perfect accuracy.[6]

When a potential violator knows that this is the rule by which penalties will be computed, and when he discounts the

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[5]This calculation is made from an "ex ante" perspective. That is, the court must assess the likelihood of eventual detection and conviction as it appeared to the violator at the time he decided to undertake the illegal activity. Because this probability cannot be determined with precision, the Discussion Draft sensibly requires the fact finder to do no more than determine whether any particular organization chose a criminal activity or mode of operation that is unusually difficult to detect and convict. A particularly high multiple is then applied to the base in setting a criminal penalty for such organizations.

[6]This statement presumes that prospective violators are risk neutral. The possibility of risk averse or risk seeking violators is unimportant when potential violators are organizations rather than individuals.

likely sanction to take into account his chance of escaping detection and conviction, he is forced to take into account the full cost to others of his unlawful activity. Each potential violator will be led to compare the benefits from violation with the costs to society of that activity, and will not violate the law unless the social benefits exceed the social costs.[7] In consequence, this penalty scheme maximizes social wealth.

Reasonable people can differ over some of the details of the calculation. Were I drafting the organizational sanctions guidelines, for example, I would increase the largest multiples -- those applied to the violations that are the most difficult to detect or convict -- above the level selected in the current draft.[8] I would also apply the same multiple to enforcement costs as is applied to victim injury. This differs from the approach of the Discussion Draft, which adds enforcement costs to

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[7]The primary insight of the economic theory of optimal penalties is that violations of the law impose an external cost on victims. The optimal penalty forces each potential violator to internalize the full social costs of its activity, thus leading all actors in society to make decisions that ensure an economically efficient allocation of resources.

In industries characterized by market failure, it may be necessary to adjust the penalty in order to achieve economically efficient behavior. Modification may be required, for example, in markets characterized by moral hazard, market power, or asymmetric information. Moreover, other modifications may be necessitated by violator risk aversion, the prospect of costly litigation, or violator errors or uncertainty in calculating the likely penalty for contemplated actions.

[8]I suspect that the probability of detecting and convicting a fly-by-night fraudulent operator engaged in door-to-door or telephone sales is substantially lower than one chance in 3.5, the lowest probability of detection and conviction implicit in the draft proposal.

the penalty at a multiple of one.[9] These minor quibbles aside, I strongly support the framework adopted by the Discussion Draft.

In the remainder of this supplementary testimony, I address three issues raised by the penalty approach of the Discussion Draft. First, I consider the justification for adopting a penalty scheme that seems to find some violations of law acceptable. Second, I evaluate the extent to which the economic approach to optimal penalties serves the generally acknowledged social purposes of criminal penalties. Finally, I consider the circumstances under which monetary sanctions are preferred to non-monetary sanctions when organizations are the lawbreakers. This last issue is raised by the Draft Proposal on Standards for Organizational Probation[10] ("Probation Alternative"), the

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[9]Aggregate government enforcement costs and the optimal penalty are simultaneously determined in the sense that a higher penalty can be expected to reduce the number of violations and, in consequence, to lower governmental expenditures on detection and prosecution of lawbreakers. However, the enforcement expenditures per violation are, most likely, largely invariant to the number of violations and the level of the penalty. Under such circumstances, it is appropriate to view the social resources devoted to enforcement as a fixed social cost associated with each successful prosecution, and treat those costs as part of the penalty base.

Some may contend that a penalty that rises with enforcement expenditures gives the government no incentive to minimize litigation costs. This argument would be more credible were the Justice Department budget funded from damage recoveries. To the extent this is a concern, however, the sentencing guidelines could add a fixed increment to all estimated losses equal to the average enforcement cost per violation. Downward adjustments in the penalty base would then be appropriate when defendants settle before trial or cooperate substantially in investigations, and thereby reduce enforcement expenditures significantly.

[10]Coffee, Gruner, and Stone, Draft Proposal on Standards for Organizational Probation (July 1988).

alternative proposal for organizational probation that was circulated in conjunction with the Discussion Draft.

IV. Justification for Permitting Efficient Violations

If Congress, in drafting the statues defining federal crimes, has correctly identified those activities which harm society in excess of the benefits to the violator, the optimal penalty framework adopted by the Discussion Draft would in principle deter all lawbreaking. In actual application, however, the optimal penalty approach will not deter all violations. In particular, violators will continue to engage in those criminal activities for which social benefits exceed social costs.

Such violations are termed "efficient" in the economic literature on optimal penalties. If this terminology suggests that these violations will go unpunished, it is misleading. Under the optimal penalty scheme, all violators must pay an appropriate multiple of the harm they cause others.[11] A court is never put in the position of excusing violations from the penalty on some theory of efficiency.

The economic approach is not unique in failing to deter all violations. Every plausible scheme of criminal sanctions recognizes that complete deterrence is frequently a prohibitively costly aspiration rather than a realistic possibility. Let us suppose, for example, that if we put a police officer on every

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[11]All violators who are detected are prosecuted and penalized, including lawbreakers for whom the violation is "efficient."

street corner, all pickpocket activity will be deterred. The fact that we choose not to spend social resources in this way, so that some pickpockets find it attractive to engage in their unlawful activity, does not mean that we think some pickpockets are "good actors" who should go unpunished. It merely recognizes that a tradeoff between increased compliance expenditures and increased violations is implicit in any scheme of sanctions.

Moreover, the optimal penalty model ensures that private compliance expenditures are made in a manner that is the most beneficial to society. We would all applaud a police department that deploys its anti-pickpocket street enforcement squad in an area of town with dense pedestrian traffic, rather than an area where no victims or pickpockets congregate. The economic approach to optimal penalties applies this insight to setting sanctions. If it is uneconomic to deter all crimes, we should create our scheme of sanctions so that we deter first those violations that are extremely harmful to victims and do not greatly benefit violators. This is accomplished by the economic model of optimal penalties.

V. Social Purposes Served by Criminal Penalties

The scheme of penalties implied by the economic model seeks in the first instance the general deterrence of criminal violations. These penalties ensure that firms throughout the economy do better by setting out to obey the law rather than by intentionally engaging in harmful practices like defrauding consumers, selling contaminated foods, or dumping toxic wastes. They further ensure that firms find it in their interest to institute compliance programs, investigate the background of employees, and take similar measures to avoid most violations through negligence. Moreover, the penalties implied by the economic model lead to a level of general deterrence of lawbreaking that maximizes social wealth.[12] These penalties generate the largest possible surplus of wealth creating activities (less the social costs of violations, enforcement, and compliance programs).[13]

In accomplishing general deterrence, the optimal penalties serve in no small measure two other important goals of a system of criminal sanctions.[14] First, because optimal penalties are a multiple of victim injury, fines collected from those violators who are not judgement proof will often be sufficient to permit

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[12]More precisely, these penalties lead to an efficient allocation of resources across economic activities, including the allocation of corporate resources between the production of goods and compliance with the law.

[13]Very high penalties (e.g. life imprisonment for all employees of firms committing criminal violations) would reduce violations to near zero, below the violation level implied by the optimal penalty model. Although such penalties would make governmental enforcement expenditures virtually unnecessary, they would be extremely costly to private actors. Firms would find it necessary to engage in extensive and time consuming compliance activities, reducing their efforts on productive activities.

[14]<u>See generally</u> Parker, <u>Criminal Sentencing Policy for Organizations</u> (United States Sentencing Commission Staff Working Paper) (May 1988) at 35-47. In the event these other goals conflict with the general deterrence goal served by the economic model, however, they cannot be pursued except by reducing total social wealth.

full compensation to victims.[15] The Discussion Draft properly requires that these funds be used for compensation whenever feasible. Second, the optimal penalties implied by the economic model give violators their just deserts in the sense that the most injurious violations will call forth the greatest penalties.[16]

VI. Monetary vs. Non-Monetary Sanctions

The Probation Alternative differs from the organizational probation provisions of the Discussion Draft in ways that contest the applicability of the economic model to organizational sanctions for criminal violations. In particular, the Discussion Draft framework is said to threaten the legitimacy of the criminal justice system and to insufficiently deter agents. This section will defend the Discussion Draft against these criticisms.

A. Legitimacy of the Criminal Justice System

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[15]However, if the victims have a pre-existing contractual relationship with the violator, and the victims are aware that they are dealing with a lawbreaker who has not yet been prosecuted, restitution may not be successful. See Baker, Private Information and the Deterrent Effect of Antitrust Damage Remedies, J. L. Econ. & Org., forthcoming.

[16]Some argue that no finite amount of money can compensate victims of violent crimes for their injury. This suggestion may explain why it is economically efficient to jail rather than fine the perpetrators of such crimes. If the deprivation of liberty is also costly beyond any monetary equivalent, the penalty of incarceration allows society to penalize criminals by some rough equivalent to the harm they cause victims. I am indebted to Steven C. Salop for a helpful discussion on this point.

The advocates of a large role for organizational probation suggest that the optimal penalty system is illegitimate because it does not ensure complete deterrence of criminal activity (zero violations).[17] Even if this view is correct, it does not necessarily work in favor of non-monetary penalties. So long as organizational violators are not limited in their ability to pay and fines are cheaper to enforce than probation, it is hard to see why non-monetary sanctions should be preferred to fines even if complete deterrence is the goal. After all, some level of fines will accomplish the same amount of deterrence as any level of a non-monetary sanction.[18]

The legitimacy of criminal penalties is most likely to be questioned in three situations, each of which is adequately treated by the Discussion Draft. First, it may appear unfair to some to allow a firm to continue in business after paying a fine when its criminal violation has resulted in loss of life or other extreme harm. The choice of penalty methodology is not the source of this concern, however. Rather, the problem is that many believe that the harm to victims in such a case cannot be

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[17]Probation Alternative at 9. It is important to recognize that complete deterrence cannot be obtained without lowering aggregate social wealth below the levels that would be achieved under a system of optimal penalties, because the necessary sanctions (whether monetary or not) will generate excessive firm compliance expenditures and overly cautious firm behavior.

[18]Similarly, an organization will likely view non-monetary sanctions as a cost of doing business, comparable to its view of fines. Both may be perceived equally as a "tariff system that permits corporations ... to engage in criminal behavior so long as they are prepared to pay the specified tax." Probation Alternative at 9.

measured monetarily. As the Discussion Draft implicitly recognizes[19], our criminal justice system can best handle such situations in order to protect its legitimacy by prosecuting and incarcerating corporate agents (as well as imposing sanctions on their organization).

Second, some corporations may be "bad actors." They may intentionally or recklessly exhibit a pattern of criminal behavior in apparent disregard for the long run profit incentives created by the scheme of optimal penalties.[20] Under such circumstances, it will be necessary to engage in "specific deterrence" of repeated violations by those particular lawbreakers in order to defend the legitimacy of the system of criminal justice. For such offenders, the Discussion Draft provides appropriately for organizational probation with a scheme that incorporates substantial limitations on business activity and close monitoring by government enforcers.[21]

Finally, the application of the optimal penalty methodology

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[19]Discussion Draft at 8.41 (Consideration of Penalties Against Organizational Agents).

[20]From an economic perspective, such actors may be interpreted as discounting the future at an extremely low rate.

[21]Such sanctions are appropriate until the organization demonstrates that the owners and top managers responsible for the pattern of criminal behavior have departed, and that the corporate culture encouraging disregard for lawbreaking has been modified through new procedures for training and compliance. Perhaps with this possibility in mind, the Discussion Draft provides a mechanism for early termination of organizational probation. (The departure of the responsible manager is, of course, no reason for a court to terminate or limit any sanction applied to that manager individually.)

to "judgement proof" organizations may raise both a legitimacy and an efficiency concern. The legitimacy of the criminal justice system may be threatened when violators with extensive assets are forced to pay greater penalties than other firms engaged in more harmful lawbreaking, merely because the latter firms have more limited assets. Further, a scheme of fines risks systematic underdeterrence because many organizational defendants lack the assets necessary to pay the optimal penalty. Without some further sanction, firms with limited assets would have an incentive to engage in covert and injurious violations, undeterred by the prospect of a large penalty.

These difficulties can both be addressed through increased sanctions imposed on corporate violators that are "judgement proof." As is recognized by the Discussion Draft, organizational probation can be employed to ensure that any future profits are directed to the payment of the fine. In addition, prosecutors can increase deterrence by attempting to convict organizational agents of related violations, thereby imposing additional monetary and non-monetary sanctions on them.

Organizational probation is costly to the criminal justice system both directly, through the expenditures associated with monitoring violator behavior, and indirectly through impeding the legitimate productive activities of business firms subject to the sanction. In specifying a role for probation the Discussion Draft appropriately balances these costs with the demands of legitimacy for the criminal justice system.

B. Deterring Agents

Advocates of the organizational probation alternative also question whether the optimal economic penalty imposed on an organization will adequately deter its agents.[22] They contend that sanctions are made necessary by virtue of the difference in incentives between organizations and their agents. This argument is evaluated below.

All organizations have a strong incentive to ensure that their agents act in the interest of the firm as a whole rather than in the agent's personal interest. Because firms cannot costlessly monitor the behavior of their employees, however, agents may be able to take advantage of their employer to some extent. For example, agents may be able to use corporate resources for private benefit, make decisions that advance employee careers to the detriment of firm profitability, or act illegally.

When firms are faced with the prospect of organizational sanctions equal to the optimal penalty, they can be expected to institute internal compliance programs and other monitoring mechanisms to protect against incurring those fines. Because these programs are costly to the firm, some illegal agent acts may not be deterred. That fact does not imply that somehow the firm is underspending on compliance with the law. Rather, the organization has the same incentive to monitor employees in order

[22]Probation Alternative at 5.

to avoid criminal penalties as it does to monitor employees in order to ensure that they do not shirk on the job or devote firm resources to private ends.[23]

The slippage between firm incentives and agent incentives inherent in organizations suggests that a given penalty will have more effect if it can be made to fall directly on an agent, rather than falling in the first instance on the organization.[24] The Discussion Draft properly recognizes this point by permitting the total penalty imposed on a firm to be reduced by the monetary value of the penalties imposed on agents.[25]

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[23]Moreover, the organization has a strong incentive to impose its internal controls in the cheapest way possible. Hence there is no reason expect that a firm subject to an order of probation will impose different controls than a firm subject to a comparable monetary sanction. But cf. Probation Alternative at 5 n. 1.

[24]Contracts specifying that the organization will pay the criminal penalties incurred by its agents are presumably unenforceable. It may nevertheless be possible for agents to shift some of the penalty to the firm and thereby alter the incidence of the penalty within the organization. For example, a criminally-minded agent may be able to bargain for a high salary with a criminally-minded organization in exchange for bearing some personal risk of later criminal prosecution. For the most part, however, the prospect of a criminal penalty placed on an agent directly can be expected to more greatly deter that agent than the prospect of a penalty applied to the organization.

[25]Moreover, many organizational violators are corporations that are in practice alter egos of an individual criminal. Cohen, Ho, Jones and Schleich, Report to the U.S. Sentencing Commission On Sentencing of Organizations in the Federal Courts, 1984-87 (July 1988) at 12. For these firms, there is no divergence of interest between the organization and its agent, other than that created by the limited liability associated with the corporate form of business. If such firms lack the assets necessary to pay a criminal penalty, underdeterrence is threatened. To create optimal deterrence, prosecutors must seek fines and non-monetary sanctions against the individual who seeks to use the corporate form of business as a shield from liability.

VII. Summary

The Discussion Draft proposal for organizational sanctions has two main strengths. First, it applies a sensible analytic framework to rationalize the system of organizational sanctions. The framework helps judges and prosecutors think straight about the ways in which their activity serves the goals of the criminal justice system. Second, because the analytic framework is based upon the economic theory of optimal penalties, it will maximize social wealth by ensuring the appropriate balance between productive activities and compliance programs within firms. For these reasons, I strongly encourage the Commission to adopt the Discussion Draft.

Organizational probation is a poor substitute for individual prosecution in such cases, adding little additional deterrent effect over that created by a fine in excess of corporate assets.

TESTIMONY OF HARRY FIRST
PROFESSOR OF LAW
NEW YORK UNIVERSITY SCHOOL OF LAW

BEFORE THE UNITED STATES SENTENCING COMMISSION
NEW YORK CITY
OCTOBER 11, 1988

Mr. Chairman and Members of the Commission. I want to thank the Commission for inviting me here today to testify with regard to the Commission's Discussion Materials on Organizational Sanctions, published in July 1988. I teach in the areas of antitrust and business crime, and I am therefore quite interested in how the Commission will treat organizational sanctions. Indeed, your draft has reminded me of the challenges this issue presents, and the difficulties of the Commission's task.

I would like to divide my remarks into three parts. I will begin by discussing some overall conceptual problems with regard to the question of the proper sanction for corporations. In the second part I would like to present some specific criticisms of parts of the proposal. In the third part I offer a few suggestions for a different approach.

I. Conceptual Questions

I think that there are two conceptual questions which must be approached before drafting any guidelines in this area. One is the reason for organizational criminal liability. The other is model of organizational behavior on which the guidelines should be based.

The question of the rationale for organizational criminal liability is important because the guidelines should reflect the reasons for punishment. A major difficulty in this area, however, is that the substantive law rationale for entity liability has never been satisfactorily worked out. Corporate criminal liability was first accepted by reasoning from tort principles. Courts were familiar with the idea of finding corporations civilly liable for the improper behavior of their agents; it was going only a slight step farther to find that corporations could also be criminally liable for the acts of their agents committed within the scope of authority.

In so holding, the courts paid no attention to the differences between the purpose of tort liability (to shift to the entity the risks of enterprise) and the purpose of criminal liability (to sanction for improper behavior). Instead, the tort analogy tended to stress a similar objective of the two systems, the need to impose liability to deter improper conduct.

The emphasis on the deterrence rationale, and the use of an agent-principal liability imposing rule (that is, imputing the acts of the agents to the principal), has tended to obscure another important goal of the criminal sanction, the need to punish blameworthy behavior. I believe that imposition of criminal liability on an organization (most usually, a corporation) plays a highly important symbolic role in stigmatizing the organization. It satisfies our desire to place blame on a powerful actor (an actor more powerful than an individual) for harmful results. I think that corporate managers instinctively recognize this symbolic quality of the criminal sanction when they choose to litigate criminal cases whose potential fine may be far less than the costs of litigation.

I take from this the importance of maintaining a strong element of just deserts in any penalty scheme for corporations. If this is blameworthy behavior, it is then proper to provide an appropriate penalty, one freed of a market calculus of costs and benefits which is the hallmark of a system of deterrence. Indeed, I believe that there is something to be said for basing a system of punishment at least in part on the notion that the law should be obeyed because it is the law (even if we are willing to recognize that there may be cases where the marginal cost to society of extra deterrence is greater than the marginal benefit that would be conferred on society).

Closely linked to this question of the rationale for corporate criminal liability is the second question I have posed, the model of organizational behavior assumed in the system of penalties. If one assumes that "the corporation" is a "rational actor" guided only by profit-maximization, and if one adds to that assumption the view that deterrence is the only reason for corporate criminal liability, then the system of penalties can be directed exclusively at a rational calculus--make improper behavior "unprofitable."

On the other hand, many people have been critical (correctly, I believe) of the view of the corporation as a "rational actor." A corporation is not a person, nor is it a production function mechanically combining inputs in the way which will most efficiently produce outputs. A corporation is an organization, and the larger the organization, the more complex its behavior. Under this view, corporate activities are not "rational acts." They are organizational outcomes, dependent on a complex interaction of corporate procedures, goals, and organizational structures (and even "corporate cultures"), in a setting where managers pursue potentially conflicting agendas of their own. Even in the context of a deterrence only view of the criminal sanction, penalties geared exclusively to a calculus of unprofitable behavior will not achieve the deterrent effects sought.

The proposed guidelines provide an admirably clear and consistent answer to the two conceptual problems I have posed. The purpose of punishment is to provide organizations with "measured incentives for insuring their compliance with federal law" (at p.8.2). The model of the corporation is the rational actor, "business corporations . . . motivated primarily by profit and loss" (at p.8.1).

I do not disagree with the desire to provide "measured incentives." I do disagree with the view that providing incentives to avoid loss is the only goal of the corporate criminal sanction, and I do disagree with the exclusive reliance on economic theory for measuring these incentives. An "economics-only" approach cannot satisfactorily reflect the deserts goal of punishment, or deal with the organizational complexity which some (but not all) corporations present. Indeed, the substantive law for imposing corporate criminal liability is gradually moving from a simple agent-principal imputation rule to a more complex acknowledgement of organizational fault as an important aspect of imposing criminal liability. Punishment should recognize this development.

II. Problems With the Proposed Guidelines

Accepting, for the moment, the underlying premises of the proposed guidelines, I would like to suggest what seem to me to be some serious problems with the guidelines.

A. The Formula For Optimal Deterrence

The Commission has chosen a clear formula, consistent with economic theory, for the optimal amount of deterrence: (the cost of the crime) x (the chance of successful prosecution) + (enforcement costs) - (other penalties). Application of the formula raises many issues. I would like to focus on a few.

1. Determining Loss: I think that the Commission underestimates the difficulties likely to occur in estimating losses. First, based on the data used by the Commission, it does not appear that loss estimates are now done on a routine basis in a Presentence Investigation report; in the 1984-1987 survey, such an estimate was made in only about ten percent of the cases. Second, in cases with large potential fines, I am not certain that either defendants or the courts will be willing to accept

"reasonable estimates" of loss; more accurate proof will likely be required. What makes this of particular concern is the uncertain interrelationship between a court determination of loss and subsequent civil litigation. Defendants might be quite concerned with this estimate if they felt it had carryover effect on such litigation; on the other hand, full litigation might have some potential collateral estoppel effect in subsequent litigation. Third, there are many federal crimes where the loss is difficult to measure or is intangible. These crimes may involve "soft property rights" (sale of bootlegged records, or confidential information[1]) or simply improper behavior (bribery of foreign officials[2]). Fourth, economic theory requires consideration of social cost, not private cost. Although the guidelines make some attempt at assessing social losses, the prospect is daunting.[3]

2. The Offense Multiple: The base multiple is at least easier to apply than the loss estimate, but I do not see how the Commission can have any confidence that it is right. First, the study upon which the Commission relies for choosing the 2.0/2.5

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[1]In such a case, gain to the defendant might be used rather than loss to the victim. Although such an amount could be more readily ascertained, this amount would no doubt underestimate the value to the rightful owner and to society. Thus, a penalty based on price paid would underdeter the violation.

[2]Curiously, this might be a case of social gain to the United States in terms of increased business, with no measurable social loss.

[3]For example, when medical waste washes up on beaches, should we account for lost income in resort areas, or the value of lost vacation days?

multiple disclaims "statistically valid generalizations concerning differences across categories" (specifically mentioning the higher multiple for government fraud). Second, the sample relied upon in the study is quite small (about 7% of cases involving corporate fines in the period). Third, the data are based on current sentencing practices. There is no reason to believe that a court today in imposing a fine would have considered and attempted to determine the chances of successful prosecution (detection and punishment), which is the "basic concept" of the multiple. Fourth, it is difficult to imagine how one could accurately go about the task of estimating the chances of successful prosecution in any particular class of crime. This would require knowledge of the amount of crime which is undetected; of the amount of corporate crime which is handled through alternate administrative remedies and never referred for criminal prosecution; and of the number of cases which are not successfully prosecuted.

3. <u>Adjustments to the Multiple</u>: Consistent with the economics-only approach, Section 8B3.2 provides adjustments to the multiple based on detectability characteristics. One of these characteristics is "open and obvious" conduct. From the point of view of the economics-only theory, this ought to lower the penalty, because the commission of "open and obvious" illegality should lower the expected gain in the eyes of a rational actor. (One must ask, of course, why a rational actor-corporation would proceed in a way which increases its risk of

being caught and prosecuted; this sounds like irrational behavior.) However logical this factor might be within the Commission's framework, it illustrates the conflict between the guidelines theory and common sense notions of desert. The guideline appears to say that cases of blatant illegality should be punished less severely. I would doubt that many would believe that flagrant offenders (say, dumpers of medical waste who do not even bother to remove identifying labels) should receive lower punishment. If anything, the punishment deserved might be higher because such behavior exhibits indifference to the dictates of the law. That the logic of the economics-only approach should produce such a result should be a caution to the Commission.

4. Collateral Civil Penalties: Section 8C5.5 identifies a very difficult and important issue, the haphazard way in which a criminal conviction of a corporation can trigger other penalties. Indeed, for all we know the collateral consequences of a criminal conviction may prove to be far more severe than any maxima set as a criminal penalty. Collateral consequences may include debarments by federal, state, and/or local governmental agencies; disqualifications for certain business licenses; treble civil damages; or (as E.F. Hutton discovered, for example) a loss of business reputation impossible to predict or prevent. These penalties vary more by offender than offense, thereby creating potential disparities in effective sentences.

The problem here is implementation. I just do not see how a judge can deal with these issues at sentencing. Very often (indeed, probably in most cases) these collateral consequences are not clear until some time after conviction. Unless the judge is willing to defer sentencing for a substantial period of time, the judge will be required either to guess at what will happen or simply to ignore the problems.

5. <u>The Uselessness of Estimates</u>: There is no doubt but that one can come up with rough estimates for each component of the formula. The problem is that the theory depends on accurate estimates. The logic of the theory depends on giving corporations the correct number so that corporations will neither be over- nor under-deterred. We will then have the right amount of deterrence (or, put less benignly, the optimal amount of crime). If, however, the number systematically understates the value of the loss and systematically overstates the likelihood of being caught and punished, rational corporations will not be adequately deterred. They will--indeed they should, according to the theory--determine that it is worth it to violate the law.

Underdeterrence, it seems to me, is the most likely result of the estimates the guidelines choose. Underdeterrence is likely because the guidelines generally exclude social costs and because the base multiple is likely too low (I find it hard to believe that, at worst, a corporation has about a 30% chance of being caught and punished for crime, as the high-end 3.5 multiple would suggest). The guidelines will, of course, produce some deterrence, but they cannot produce the right amount of deterrence as called for by the theory. It is as if the Commission sought to get to the moon by driving a car uphill. You would be somewhere, and a bit closer to the goal; but you would not be anywhere near the moon.

B. The Antitrust Guideline

The Commission requested comment on whether the existing antitrust guideline for organizational sentences should be integrated into the proposed guidelines, and whether the existing guideline should be changed.

It seems obvious to me that antitrust offenses should be treated within the same framework as all other offenses. They are so treated with regard to individual penalties. It also seems obvious to me that if, within this framework, the penalties imposed are to be different, the Commission should explain the reasons for choosing different penalties.

If the Commission adopts the proposed guidelines, there will be substantial differences between corporate sanctions in antitrust and in other offenses. First, the antitrust guideline specifies an offense multiple higher than any other offense (2.0 to 5.0 for antitrust, as opposed to 1.0 to 3.5 for all other offenses). Second, there is no reduction in the antitrust guideline for "compensation to victims . . . expected from the organization," which would include damages in civil cases; indeed, the antitrust guideline assumes that treble damages will provide "additional monetary penalties." Third, there is no consideration of departures or reductions which would otherwise be relevant to antitrust cases (for example, coordination of collateral remedies, such as debarment, or reductions for compensation to victims or fines against responsible organizational agents). Fourth, the antitrust guideline suggests consideration of recidivism; the proposed guidelines do not. Fifth, there are no provisions in the antitrust guideline for community service or probation. Sixth, and cutting the other way, the antitrust guideline provides no addition for the cost of prosecution.[4] The net of all these differences, however, is that corporate criminal sanctions for antitrust offenses will be significantly higher than for other offenses in terms of the conceptual framework chosen.

Integrating the antitrust guideline into the proposed conceptual framework will require changing the antitrust guideline, or explaining the reason for taking a different approach. In either event the Commission will need to justify what it did not justify when it adopted the antitrust guideline in the first place--the amount of loss and the multiple.

In terms of the offense loss, the Commission has decided that the "average additional profit" attributable to price fixing is 10% of sales. I am not aware of any empirical support for this number, nor has the Commission ever provided any support

[4] I note that the staff working paper suggests including enforcement costs for antitrust offenses. See Parker, Criminal Sentencing Policy for Organizations at 53 (1988). The paper also includes the value of output not produced by virtue of the price-fixing (the "deadweight" welfare loss), see id., a loss that economists would identify as the social cost of price raising behavior. The antitrust guideline makes no attempt to identify or measure this loss.

for it. Further, the guidelines do not permit a defendant (or the government) to challenge it. It is, simply, an arbitrary guess.[5]

The same is true for the multiple. There is no apparent support for the 2.0 to 5.0 required. The Commission's staff paper points out that the Antitrust Division had estimated a multiple of 10; but the support for that estimate is the unsubstantiated testimony of the head of the Antitrust Division, and his testimony seems more designed to produce a fine equal to total sales (the estimated 10% of sales times 10) than to arrive at a figure which is, in fact, correct.[6]

Whether any of this matters, however, is another issue. The maximum stated corporate fine under the Sherman Act is $1 million. Using the lowest 2.0 multiple, corporate defendants in bid-rigging conspiracies will therefore "max out" at $5 million worth of contracts, hardly a large sum. The only way the

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[5]If the Commission were serious about pursuing its economics-only approach, the use of an average figure for the estimate of loss would mean that only "average" price fixing conspiracies will be adequately deterred. Less-greedy price-fixers will be overdeterred; and more rapacious price-fixers will be underdeterred.

[6]See Parker, supra, at 54-55; Statement of Douglas H. Ginsburg, Assistant Attorney General, Antitrust Division, July 15, 1986, at 9 (appropriate multiple "at least ten"; "Based on our experience that price fixing typically results in price increases of at least 10 percent, such a multiple would indicate that the appropriate fine must be at least equal to the total amount of sales made . . . . ").

In truth, there is no reasoned basis for choosing any particular multiple, because no one has any factual support for any particular choice. My personal arbitrary guess is that 10 is too low. I doubt that we catch and successfully prosecute one out of every ten price fixing conspiracies.

government will be able to obtain a higher fine (as would likely be called for under the guideline in effect and perhaps under one more consonant with the proposed guidelines) would be to prove to the sentencing court what the amount of the loss or gain actually was, so that it could be doubled as provided for under the Criminal Fine Improvements Act. Whether the government will be willing to enter this litigation morass has yet to be seen.

C. <u>Taking Account of the Organization</u>

There are two guidelines in which I think that the Commission could take better account of the fact that a corporation is not a person, and the fact that every corporation is not identical. One involves accounting for sanctions imposed on corporate employees; the other involves corporate probation.

1. <u>Penalties Imposed Against Corporate Employees</u>: Section 8C5.6 permits a court to consider decreasing a corporate fine to reflect the criminal penalties imposed on its employees; it includes an allowance to the corporation for the value of the services lost.

This guideline again raises basic questions about the reasons for corporate criminal liability and the Model of corporate behavior upon which the guidelines are based. Why punish two actors for what may be "the same" act? Taking an economics-only approach, combined with a view of the corporation as a rational actor, there is no reason to punish twice. The penalty should be no larger than theoretically required. The question, then, is only how to allocate the penalty. The guideline subordinates the corporation's liability to the individual's, so long as the individual can pay.[7]

I would urge the Commission to take a more organizational approach. This guideline provides the Commission with an opportunity to distinguish between large corporations (with diffuse responsibility and complex decision-making processes) and small entities whose principals can readily be identified. I view larger corporations as institutions separate and apart from the particular individuals who make them up at a particular time. Even a deterrence-only approach would require focusing the monetary sanctions completely on the organization. Moreover, from a deserts point of view, reducing the fine for a large corporation by the amount an employee pays sounds like forgiving the penalty. Reducing it by the value of lost services sounds like the Commission is intent on making certain that the corporation is not punished.

On the other hand, in a corporation where the convicted employee has a substantial ownership interest (say, 10%), there is a closer identity between the employee and the corporation; fining both may, in fact, be a double penalty. I would recommend, therefore, that in such cases, the corporation's fine be

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[7]This guideline appears to be inconsistent with Section 8B3.2(a)(1), which calls for an increase in the multiple for participation by high management; 8C5.6 then acts to decrease the fine. The guideline also appears to duplicate Section 8B3.2(b)(1), which calls for a decrease in the multiple for efforts to control agents; the commentary to 8C5.6 indicates that a fine reduction is particularly appropriate where the organization has made a good faith effort to control its agents.

reduced by an amount equal to the principal's fine.

2. Probation: The Commission's approach to probation is far too narrow and discouraging. The legislative history of the Sentencing Reform Act does not require such a limiting approach,[8] nor is such a narrow approach consistent with the purposes of corporate criminal liability, unless one cannot move beyond the economics-only deterrence approach. Indeed, probation for corporate offenders is quite appropriate for a goal of criminal punishment that we seem to have given up on, rehabilitation. It offers an opportunity to improve the offender, and diminish the chance that the offense will be committed again. Corporate probation can be tailored to the crime involved (improper payments abroad could produce one set of probationary conditions while fraud in government procurement might require another) and can make use of the corporation's own resources to structure appropriate procedures to prevent future violations.

I would encourage experimentation with corporate probation, subject to a minimization requirement to discourage overly intrusive efforts. Professors Coffee, Gruner, and Stone have done an admirable job in making the probation suggestion concrete. I would only echo their view that many of the most

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[8]The portion of the legislative history on which the Commission relies (see p.8.5) does not support the Commission's reading that Congress intended probation be directed "toward limited objectives." The debate referred to involves the question whether debarment should be a condition of probation and the concern that probation might place "business conditions on an organization that are unrelated to the purposes of sentencing for the offense of which the organization is convicted." See S.Rep. No. 98-225, at 99.

commonly suggested probationary conditions are already being performed by corporations, sometimes during the course of a criminal investigation and sometimes after conviction.

III. A Suggested Alternative

As my previous remarks indicate, I do not think the Commission's approach will achieve the goal it seeks. The fines will, of course, deter (any fine will deter something). But they cannot, except by luck, deter as the Commission wants.

I would urge the Commission to abandon the current conceptual framework in favor of a much simpler approach which accounts for deserts, deterrence, and harm. The approach is based on the size of the offender, but varies the fine depending on estimates of responsibility and economic harm. My suggested approach is not as fully articulated as the Commission's, but I believe it can provide a useful basis for approaching the problem.

I propose this approach for several reasons. First, in the context of a sentencing hearing, corporate size (whether assets or total sales) is a much easier fact to determine than gains or losses, and it has no collateral implications. Second, the use of a "size of the offender" base for the fine is consistent both with deterrence and just deserts. In deterrence terms, making the cost of a violation more transparent at the time the corporation engages in the improper behavior might provide a more certain deterrent. More critically, "no pain, no gain." An equal sized fine just does not pinch a large organization the same way it pinches a small. Finally, in retribution terms, an equal dollar fine against a multinational corporation and a small contractor does not seem equivalent. People should be treated equally under the law, but I do not believe that organizations deserve the same punishment for the same conduct regardless of size. Indeed, I draw this conclusion not only from my own views, but also from the Sentencing Reform Act itself. The Act requires the court to consider "the size of the organization" when imposing a corporate fine (18 U.S.C. 3572).

I would suggest that the determination of an organizational sanction follow three steps: 1) sentencing matrix; 2) statutory override; and 3) organizational considerations.

1. Sentencing Matrix.

		Economic Impact: Low	Economic Impact: High
Responsibility	Low	x%	x+a+b%
Responsibility	High	x+a%	x+a+b+c%

I am not certain what the value of x, a, b, or c should be, or whether they should be equal amounts. Nor am I certain whether one matrix would be adequate for all federal crimes. "Responsibility" would encompass primarily the degree of organizational responsibility, and would depend upon the extent to which corporate procedures were lax or high management was involved. I note that the matrix varies punishment depending on harm. The Commission indicated that it rejected using organizational size because size alone does not necessarily render an offense more harmful in terms of the loss (p.8.2). The matrix thus meets this concern.

2. Statutory Override. The government should have the option (and the burden) of proving loss or gain. If doubling this amount would provide a fine in excess of the fine produced by the matrix, the court should impose that amount. Unless the government proves loss or gain, the maximum fine should be the amount provided for in the Sentencing Reform Act.

3. Organizational Sanctions. Consistent with the suggestions I made above, I would urge that the fine be reduced by the amount of a principal's (10% equity owner) fine and that suitable probationary conditions be imposed.

IV. Conclusion

The Commission has made a valiant and laudable effort to apply an economic-theory framework to the problem of organizational sanctions. Unfortunately, I do not think that the guidelines produced, as well worked out as they are, can achieve the goal the theory seeks. Indeed, the magnitude of the effort to reduce theory to practice counsels abandonment of the theory.

I have suggested the outlines of one alternative. I am sure there are others. Whatever approach the Commission takes, however, I would urge that the guidelines be applied to all offenses, including antitrust.