UNITED STATES SENTENCING COMMISSION

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UNITED STATES SENTENCING COMMISSION

PUBLIC HEARING ON ORGANIZATIONAL SANCTIONS

Courtroom, United States Courthouse

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Tuesday, October 11, 1988

10 a.m. - 4:30 p.m.

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CHAIRMAN WILKINS: We call this hearing to order.

Dr. Moore, you can come up now and be seated if you like.

We welcome all of you to this first of several public hearings on organizational sanctions.

Several years ago we were in this courtroom addressing guidelines for individual defendants, and one witness who addressed the Commission called us seven devils. But we pressed on and promulgated guidelines for individual defendants, and now we are about to process the guidelines for organizations.

We are in the very preliminary stages of debating, working out and discussing the appropriate approach to organizational sanctions, and we intend to follow the same process we followed in the past and that is to receive as much public input as is possible on each issue that we must resolve before we promulgate the guidelines for organizations and submit them to the Congress.

With that in mind, we are very pleased to have a distinguished group of witnesses who will testify in this first hearing. We have already scheduled

another hearing on the West Coast later on this year, but today we will concentrate on the issues that these witnesses will bring to us.

We have asked the witnesses to summarize their remarks and perhaps take no more than fifteen minutes in their presentation to us to allow the Commission time to ask questions of the witnesses. We found in the past that this is the most productive time spent.

Our first witness is Dr. Thomas Moore.

T H O M A S M O O R E, called as a witness, stated as follows:

CHAIRMAN WILKINS: Dr. Moore, we are delighted to have you with us. Dr. Moore is a member of the President's Council of Economic Advisers and has done a great deal of work already in addressing many of the issues that we are going to have to address.

We are very pleased to have you with us and we look forward to hearing from you.

MR. THOMAS MOORE: Thank you, Mr. Chairman. I appreciate the opportunity to appear before the U.S. Sentencing Commission on the important issue of sentencing guidelines for organizations.

I recently chaired an interagency Working Group on Corporate Sentencing that prepared a memorandum for the Domestic Policy Council. The Domestic Policy Council subsequently adopted the position taken by this memorandum concerning the principles which should govern corporate sentencing. This memorandum was previously submitted to this Commission in April of this year.

Having reviewed the Discussion Draft of Sentencing Guidelines that were issued in July, I am pleased to note that these Draft Guidelines conform in most significant respects with the principles set forth in the DPC memorandum. I am concerned, however, with certain aspects of those Draft Guidelines.

First, 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 while deterring. 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.

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 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 society's 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. 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.

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 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 noneconomic character.

The Draft Guidelines should perhaps be revised to make it more clear that the courts should consider the full range of social harms resulting from a crime in determining the appropriate offense loss figure. These might include, for example, in a bribery case, 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.

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. 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 underdeterrence. 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 using 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.

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, not probation. 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 a 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 for subsequent offenses, rather than probation, is warranted for repeat offenders.

I would suggest that the Commission give serious thought to narrowing the conditions under which probation can be imposed.

Economic theory suggests that the optimal penalty for a fine, 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 to allow offsets against the organizational criminal sanctions for amounts paid as collateral civil or criminal penalties by the firm or its agents. Otherwise, the aggregate penalty will be excessive.

I have two final comments regarding the Draft Guidelines' penalty calculation formula. First, under this formula as set by the Draft Guidelines, only actual enforcement costs are added to the penalty amount. This is wrong. Enforcement costs should first be increased by the offense multiple. The Draft Guidelines formula should be revised so as to add actual enforcement costs to the offense loss figure before the resulting sum is

multiplied by the offense multiple.

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. 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.

A second comment I have regarding the penalty calculation concerns the size of the offense multiples. The Draft Guidelines provide for base offense multiples of 2 to 2 1/2, and for a total range of offense multiples from 1 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. I wish that I believed that the criminal justice system was that successful. 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 multiples of between 5 and 10 are probably justified for at least some offenses.

Thank you, Mr. Chairman. I am happy to answer any questions.

CHAIRMAN WILKINS: Thank you very much, Dr. Moore.

Should the amount of the criminal sanctions, in terms of the fine, be calculated and then imposed, and, in addition to that, a requirement be imposed to pay restitution, or should restitution be deducted, in your judgment, from the calculated fine?

MR. MOORE: Restitution should be deducted. If you add it on, it is in fact going to result in overdeterrence. If you made the correct calculation to start with, assuming that you have taken into account the full social cost and have the appropriate multiple, which as I suggest is probably much higher than what was suggested in the guidelines, then you would want to subtract out any restitution, so that you do not overdeter, because overdeterrence, again, results in excessive spending by organizations to deter crime, which is very costly to society.

CHAIRMAN WILKINS: I noticed in your

statement that if a small corporation, in terms of assets, commits the same offense as a big corporation -- maybe that is our word -- you would argue that they should be punished the same as far as the amount of fine is concerned.

MR. MOORE: If the offense, say, costs society a million dollars, it doesn't matter whether it comes from the largest corporation in the country or a very small corporation, the offense cost to society is a million dollars. That is what the fine should be based upon.

CHAIRMAN WILKINS: And if the big corporation commits that same act again because it is determined that it is more a cost of doing business than the first time around, would you increase the crime the second time around?

MR. MOORE: I would increase it the second time around for both the big and the small, because what it suggests is that the fine was inadequate the first time. Either we made a mistake in estimating the social cost and the gain to the corporation, or we made a mistake in estimating the multiple. The fact that they did it the second time suggests we are not properly deterring. So I would increase it for both the big and

the small.

CHAIRMAN WILKINS: One final question. I notice in your comment today about probation, which is a difficult and controversial issue, that you would suggest we need probation to enforce the criminal sanctions imposed by the court.

MR. MOORE: You would use probation as necessary to have the fine paid and have restitution paid. That is an appropriate use of probation. But an ongoing probation to monitor what the corporation is doing leads us down the line of government regulation. We already know -- and Commissioner Breyer knows better than almost anybody here -- that regulations don't work very well, and certainly they are not going to work very well, from a judge who has no experience in monitoring a corporation's behavior.

CHAIRMAN WILKINS: Maybe we ought to forget about probation for corporations because the judge has the power of contempt to enforce the orders of the court to pay this restitution, pay this fine. So what happens when the corporation violates probation, bringing the corporation back into court, and I say, you violated the probation. Therefore I am going to do what? What does the judge do? He has nothing more than the ordinary

power of contempt. It may not be that probation will enforce anything.

MR. MOORE: I am not a fan of probation, as I say. There may be cases where a smaller company or any company is not in a very good financial situation, but if given a period of time over which to pay the fine or pay the restitution could do so, it might pay, and it might be desirable for the court to give it probation, that it must make these payments over a certain time period.

CHAIRMAN WILKINS: Let me ask any of the commissioners to my right if they have any questions, and then I will go to my left. Mr. Block?

COMMISSIONER BLOCK: A few questions, Dr Moore. One on the loss calculation, and the other on the multiple.

With repect to the loss calculation, basically the penalties on a loss as opposed to some other measure, while I am a strong supporter of that, I often hear the complaint that the monetized loss does not adequately reflect the seriousness of criminal offenses. Do you have a comment on that issue?

MR. MOORE: Well, I believe the loss should include the social costs, whatever they are. That is

why I gave the example in my testimony that if you had a bribery case of a government official, it's not just a dollar loss there. There is a loss to society in terms of respect for government behavior, and that should be added in as a part of the social cost. So we consider that that is more serious. We want to take into account that I think a lot of people consider as the harm, the total harm to society from these effects and not just the more narrow monetary cost that they extracted. That is why you don't want to use gains, because gains are almost always going to underestimate the social cost; in fact, almost in all cases. You want a larger number than that, and that is the social cost.

COMMISSIONER BLOCK: So if I could categorize that, it is really the difference between the monetizing loss and a simple monetary loss. You want to monetize the nonmonetary aspects of the loss to get a value total?

MR. MOORE: That's right, you want to monetize the noncash losses.

COMMISSIONER BLOCK: Let me follow with one brief question on multiples, something that confuses me, and that is: In the beginning part of your testimony you indicated that one of the important parts of the

structure of the draft is the focus on optimal deterrence, that is, there are some instances where monitoring costs exceed the loss imposed by the fine. Then you came back and said one of the problems of the structure of the draft is in fact that we don't increase the multiple for recidivism. Can you reconcile those two? Aren't there cases where in fact it is not optimal to increase the multiple for the second offense? And what rules of thumb would be used to get at that issue? It seems to me that is an important but difficult issue.

MR. MOORE: Are you suggesting that there are some crimes where it is optimal to have people just pay the fine and commit the crime?

COMMISSIONER BLOCK: I thought the implication of your testimony on the business monitoring was that there are some cases where the monitoring cost may outweigh the --

MR. MOORE: We want the corporation to monitor its employees to make sure that they don't commit a crime on behalf of the corporation. On the other hand, we don't want the corporation spending excessive resources so it is spending all of its time making sure that its employees are not breaking the law, because then the corporation won't be performing its

primary function, which is to make goods and services available to society. So we don't want to have excessive monitoring. We want to have an optimal deterrence, which means that there are going to be cases where an employee of a corporation breaks the law, because they probably misjudge the probabilities of getting caught. We want to have an optimal fine and sanction for those cases. I am not sure I am understanding your question.

MR. BLOCK: Let me try to rephrase it. If in fact there are some cases where it is very difficult for the firm to monitor and in fact, besides that, it will only invest X amount in monitoring, why would we then increase the penalty by increasing the multiple, if that was an optimal decision to begin with?

MR. MOORE: Well, because there is some prima facie evidence that if the same corporation keeps breaking the law, they are not being adequately deterred. They don't have an adequate amount of monitoring, or maybe the punishment of their agents is inadequate. But somehow in this combination there is not an adequate deterrence, because if there were they wouldn't keep breaking the law. That is the prima facie evidence. And we don't know with certainty what the

right multiple is. We don't know with certainty what the social harm is of most things that we can get, but we can get some rough idea. So when we have a piece of evidence that suggests that we have underestimated those, we ought to use that piece of evidence.

COMMISSIONER CORROTHERS: Dr. Moore, you stated your support of the position of the system based on loss, and it probably is correct in most instances, the loss against the gain. However, it is necessary to exact just punishment, deterrence, and, as you mention, respect for the law. I am thinking of those instances when the gain would exceed loss. I am concerned as to whether you think it is feasible to develop a system that would permit the consideration of gain in the instances when it exceeds loss. Would that be possible, in your opinion?

MR. MOORE: This is a very hard question, and the reason it is hard is, if the gain exceeds the loss, properly measured, then there is some question about whether the law is appropriate, because the gainers can compensate the losers and everybody can be better off. So you have a situation where the law itself is in question. But there is a presumption also, as you indicate in your question, that people ought to

abide by the law even if the law is wrong. While I am reluctant to endorse the idea, I guess I would be willing to see that you could take either the gain or the loss, whichever is higher in your estimate, because I believe it will be very few cases, hopefully a trivial number of cases, where the gain ever exceeds the loss. And whenever that occurs, I think we ought to start relooking at that law. But we could, in order to provide some deterrence and the idea that abiding by the law itself is good even if the law itself is questionable. So I guess I would be willing to go along with that.

COMMISSIONER CORROTHERS: Thank you. One additional question. I don't have a copy of your testimony, I don't know if we have it, but it appears that your lack of support of probation stems from the idea of probation as the sanction. Do you not support probation as a supplement to the monetary sanction, especially when the organization has a history of committing the particular criminal behavior, not just merely to enforce the monetary sanction which you say in response to the chairman, but as a preventive mechanism?

MR. MOORE: As I indicated in my testimony I gave and my answer to a question to Commissioner Block,

I think the better way to go is to increase the fines for recidivist organizations. I think that it is not at all clear what probation means in terms of cost to the corporation. It can be very costly if you get probation officers who are essentially trying to run the corporation. That would be very unfortunate and would be a danger, if you go down the probation route and leave it open, that you are going to get into the courts and probation officers meddling in areas where they have no knowledge and where they are likely to make things worse.

I would think that the thing to do is use the fines, and then the corporation knows what it is going to face. If you use probation, as I said, on top of it, it could be very costly to the corporation, or it could have no cost at all in terms of a slap on the wrist.

The worst possible kind of thing would be to ask the corporation to go out and do good works. Then a corporation will obviously advertise that they are doing good works and they will look good in the public eye. We all want to look good in the public eye. So we don't want to encourage corporations to encourage this kind of probation. It can be a slap on the wrist or it can be excessively high cost, and there is no way for the

corporation or for us to know which it is going to be.

So we better stay with the fines. We know what they are going to be, and they can impose the right costs.

COMMISSIONER CORROTHERS: Thank you.

CHAIRMAN WILKINS: Anyone to my left? Ms. Nagel?

COMMISSIONER NAGEL: I take it that it is your concern for overdeterrence that leads you to want to subtract from what you observe to be the optimal fine any moneys issued in terms of restitution of civil or other collateral penalties. At the same time there is the reality of plea bargaining, plea negotiation, which in all likelihood will result in a pattern of fine that is less than the optimal that has been derived. When you combine the concern, on the one hand, for overdeterrence and, on the other hand, the inevitability of plea bargains, don't you in effect produce a system that will almost always leave you with fines that are inadequate to deter? And if so, how do you build that into your system?

MR. MOORE: Plea bargaining is a very difficult situation, but I guess it depends upon how you think plea bargaining works. If plea bargaining works

in terms of the corporation or the offender who said, well, the maximum that we will pay is X amount, and the prosecutor and the judge settle on that amount, then that X amount may be independent of whether that is what you start with. It's a matter of what the prosecutor is willing to spend in time and effort and the judge in taking the offender to court, as a tradeoff.

So it is not at all clear to me that if you start off with a overdeterrence fine, that you wind up with the appropriate fine afterwards.

COMMISSIONER NAGEL: I don't think you will. What worries me is if you start off with the optimal fine and you know that in 85 percent of the cases they are negotiated down from there, then the system doesn't, it seems to me, take that into account, and you know as a given that in 85 percent of the cases you are going to have a fine that is less than the optimal, especially since you are worrying about overdeterrence on the other side.

So my question is, how do you build it into the system? It seems as if the system you are advocating is one that is based on a kind of theoretical purity, but the criminal justice system doesn't operate in that manner. How do you essentially take account of

the practical fact that it is not a theoretically pure system, and if not, are we going to be faced with a system where we always have fines that are too low because they won't be the optimal fine to deter?

MR. MOORE: It may be that even if you started off with a system of fines that are too high, you still wind up with 85 percent of them being too low. That depends upon how this bargaining system, which I am not an expert on, in terms of plea bargaining works. I think plea bargaining has its own optimal principles involved in terms of what you fine the offender. What is it going to cost you to prosecute that offender? What are the probabilities of success? The offender looks at what are the probabilities of being found guilty. What is the cost of their defending themselves? Then they reach a bargain which minimizes their total costs overall. In some sense, plea bargaining results in, after the offense, an optimum decision. But how you get that to result in optimal fines I don't know. I don't think it is desirable to start off with the wrong set of fines, hoping that you will come out with the right. Starting off with a wrong is almost inevitably going to result in your coming out with a wrong.

COMMISSIONER NAGEL: Suppose you knew that

the optimal fine was $100, let's say. Could you extend the kind of economic analysis you propose, calculate as you just did a set of parameters, find out what the likely reduction is in X amount, and then add that to the $100 so you end up with $100 in the end? Is there some way to do that, or do the two not fit?

MR. MOORE: Your assumption is that if you start off with an optimal fine of $100, to use your example, and let us say plea bargaining would have resulted in a fine of $50 --

COMMISSIONER NAGEL: Taking into account the difference between the cost of the plea and the cost of the trial. I would put that in.

MR. MOORE: The plea bargaining results in a $50 fine. Now if you said, all right, let's make the fine $200 to start with, do you wind up, after plea bargaining, with $100, or do you still wind up with $50, or do you wind up with $150? It depends upon how you think plea bargaining works. Does plea bargaining work in terms of proportionate cutbacks, in which case a $200 fine would result in a $100 fine afterward? Or does it work in terms of $50 being all the corporation is willing to settle for or the offender is willing to settle for, irrespective of what the fine was, in which

case you would still wind up with $50 in those cases where you get plea bargaining, and then those cases where you don't, you overdeter.

The thing is, the corporation doesn't know ahead of time that it is going to get plea-bargained down. It is what the fine is that the corporation envisions it is going to see that is relevant, and that should be the appropriate set of fines.

COMMISSIONER NAGEL: Thank you.

COMMISSIONER BREYER: Mr. Chairman, you may not know that Professor Moore is and was one of the great experts in deregulation of transportation, and through his writings and action saved the consumers literally billions of dollars in trucking deregulation, airline deregulation. You may know the exact number, but I guess it is twenty or thirty billion dollars a year or more.

MR. MOORE: We don't know the exact number, but I think there has been considerable saving, yes. Great success. And you contributed greatly to this.

COMMISSIONER BREYER: I say this now because we are dealing with the other side of the coin, and obviously we are dealing with an area where it is essential to regulate the corporations through the means

of the criminal law. So we have to listen with particular care, because what he says couched in economic terms is usually terribly relevant and very helpful.

Having said that, I would like to ask you about what I find the greatest difficulty in this particular draft. It seems to me there is a certain lopsidedness about it. That is, if we are focusing, from your perspective, on the economic part, it seems to me rather as if you are regulating an electricity company and you said the prices are going to depend on the cost, and then you have fifty experts to get down to a thousand decimal places the precise cost of building the boiler. And the regulator finds that out. Then you tell the regulator: In addition, put in an additional amount for whether you think electricity is good, bad or indifferent. In other words, there is a final instruction there that is so general that you could end up with any price at all.

I was a little bit worried about that, because it seems to me the loss calculation consists of what appear to be very finely calculated efforts to determine with some precision the loss, which when you throw in social losses would be awfully vague anyway.

Then there are rather vague general instructions with respect to the determination of this multiplier, and almost any number could be selected by a judge.

Do you think that that is correct? If so, what can we do about it? I don't have any definite idea what to do about it. One possibility would be to note that the statute says you are limited anyway by twice the harm to the victim. So why not just say, everybody should pay twice the harm to the victim. Take the loss and multiply by 2, because we can't go above that anyway. And certainly we don't have 50 percent chance of finding out crimes. Or if we are getting down into lower numbers, maybe you should, where you are below the statutory ceiling, take harm to the victim, multiply by 2, and then if you are still below the statutory ceiling of $500,000, let's throw in a large amount which we calculate in advance reflective of the social cost. That would be one way of going about it. Another way would be to make them equally imprecise and call them policy statements and leave it up to the judge.

Have you any thoughts on this? You may not. It is complicated. I am worried, though, about this lopsided quality.

MR. MOORE: First, on the ceiling on the

statutory penalties, I did not address that, and I am not an expert on that. From what you just said, it sounds to me that the ceiling may be often too low and that a properly measured deterrence-based, harm-based fine system would result in fines that will exceed the ceiling, in which case you are constrained to impose the ceiling, and recognize that those are in fact too low and perhaps Congress should address the fact and raise those ceilings.

With respect to the question of estimating the harm, I think the courts are used to estimating monetizing the costs or the results of actions which are not usually thought of in terms of dollars and cents. A person loses a limb, an eye, a family is made destitute by the breadwinner's death through some accident, and so on -- all of these kinds of things the courts are used to doing, and so I don't think it is that difficult in many cases, such as fraud. One can easily come up with some dollar estimates. One can start with the loss to the victim, that can be fairly easily calculated, and one has to think a little bit about whether in fact there is some additional social cost beyond those. In the case of fraud there may not be; that may be just the total social cost. And then one looks at the multiple.

The multiple isn't all that difficult either. When we were working with the Department of Justice in preparing the Domestic Policy Council memorandum that was sent to you all last spring, the Department surveyed their prosecutors and came out with some very interesting tables showing their estimates of the probability of somebody to commit that variety of crimes, what the probability was of being caught and convicted. There were some reasonable- looking numbers there and almost a consensus by the prosecutors. It wasn't all over the place.

So it is not impossible to get this. I think it is going to take some work to take the crimes and to talk to prosecutors, survey prosecutors and people involved, to find out what in fact their best judgment is of the probability of somebody who commits this crime being caught and convicted. While it is difficult, it is not impossible.

The alternative is, we don't have a standard. There is no alternative way of deciding what the appropriate punishment is. You can't just say, well, it is just punishment and pull it out of the air. There has got to be some logic behind it. The only logic that makes any sense is one that is based on the

harm that is inflicted on society by this action. And then you want to make, as I like to put it, the best estimate of what a just punishment is. You go back to the old testament, an eye for an eye, a tooth for a tooth. Well, that means the harm that you inflicted on society is the harm that should be inflicted on you. You should pay that cost. And what we have is the case where we are uncertain, we are not always able to capture and convict a person, so we won't be expecting an eye for an eye, but we want to inflict an expected eye on somebody. So if they inflict a million dollars worth of cost and they only get caught one out of 20 times, that means that they should pay a fine of $5 million, because they are only going to get caught one out of 20 times. And that will internalize the cost. There is no other system. I have never heard of any other system for coming up with fines. It is difficult, but it gives you a conceptual framework in which to think about the problem and to analyze and come up with the appropriate set of fines.

COMMISSIONER BREYER: The trouble with that is, it sounds like a civil system.

MR. MOORE: It sounds like what?

COMMISSIONER BREYER: I think the reason for

the difficulty is that it sounds like a civil system, it sounds like a tort system. And I am not disagreeing with you. I basically see your point. But is there something extra because it is a criminal system? I don't know the answer.

MR. MOORE: A criminal system is meant to deal an eye for an eye. That is what it is based on.

COMMISSIONER MacKINNON: Judge Breyer has mentioned the point, and of course that is the deficiency in the statement that you make, that it gets too much into the civil system. What are you going to do when you got them both, like fraud against the government? If you are going to multiply it the way you say, you are going to be applying the same test that the government will subsequently apply when they apply their fraud against the government civil action, when they bring that. You can't wrap it all up on the criminal side. Do you appreciate that?

MR. MOORE: I appreciate that there are often civil and criminal penalties, and civil and criminal cases brought on the same crime. What I argued in my testimony was that one should, to the extent possible -- and in many cases it may not be possible -- consider the punishment as a whole, including the civil and the

criminal.

COMMISSIONER MacKINNON: How are you going to do that when you are trying the criminal case first?

MR. MOORE: I said it is not always possible to do it. You cannot do it always, because if you bring the criminal first, you clearly don't know what the civil penalties will be imposed later. But to the extent one could do it and one can take account of the civil penalties, it should be done, because otherwise you overdeter. If you have appropriately fined him for the behavior the first time around, one doesn't want to impose another set of penalties on top of that.

COMMISSIONER MacKINNON: Let me give you a concrete case of what I am talking about. The government brought criminal cases against some flour millers for fraud against the government. They defrauded the government. This is a criminal case. Subsequently they brought civil cases against the same people. You always bring your criminal case first, because it requires the greatest degree of proof. Then, when you get through with that, you have no way of knowing how much is going to be paid on the civil case, which will eventuate several years later.

I know in my own case I have one which I have

in mind which started in 1953, and in the civil case they didn't pay the penalties until 1956. You have to sentence in the criminal case when it is tried. You can't speculate, and you shouldn't. You should not cut down your criminal penalty in anticipation of what might happen down the road, because it might not happen. You have to base it purely on the criminal aspects of the case?

MR. MOORE: It seems to me that the judge could -- and, as I say, I am not a lawyer -- impose the fine, defer payment of the fine until the civil case is settled, and have the civil penalties or civil payment deducted from the fine at that time. It seems to me that would be a reasonable way to go on that.

COMMISSIONER MacKINNON: They don't work out that way.

The other thing you said is that you were against making size a factor. Is that right?

MR. MOORE: Yes, that's right.

COMMISSIONER MacKINNON: Do you have any conception of the damage that some large corporations can cause over a period of time?

MR. MOORE: Exactly my point. If the damage is larger, they should pay a larger fine. It has

nothing to do with the size of the corporation. If a small corporation causes a million dollars damage and a big one causes a million dollars damage, they should be treated the same. The fact is, the larger corporation is more likely to cause a larger damage -- that is where the confusion comes in -- in which case they should pay a larger fine. But it is not based on the size of the corporation; it is based on the size of the damage they cause.

COMMISSIONER MacKINNON: When we fine an individual, we base it somewhat on ability to pay. Why shouldn't the same principle apply to a corporation?

MR. MOORE: The corporation is in the business of making money. If they do some criminal activities, they dump some toxic wastes in the river, then they do that, if they do it, for monetary reasons. We need a monetary fine system that will deter them. If you base it on the size of the corporation, you are very likely to underdeter the small corporation so that it will become profitable for small corporations to dump things in rivers, and in fact you will even encourage the development in institutions of small corporations that will be in the business of dumping things in the rivers, get fined an inadequate amount, and go merrily

on their way because it becomes profitable for them to do so. One wants to deter that activity, whether it is a big corporation or a small corporation. Therefore, you relate it to the size of the harm, which is greater than the size of the gain, and that will adequately deter both the big corporation and the small corporation.

COMMISSIONER MacKINNON: Suppose General Motors and Firestone and Standard Oil engage in a conspiracy in one place, which is eventually going to become nationwide. What is your penalty going to be in the initial instance? You mean you are not going to consider the size of the corporation?

MR. MOORE: I am going to consider the size of the harm. If you have two big corporations conspiring to do something, the harm is likely to be very large. And, yes, I would consider the size of that harm. But it is the size of the harm that is relevant, not the size of the corporation. It is not like an individual. It is based on the size of the harm.

COMMISSIONER MacKINNON: The potential harm is tremendous.

MR. MOORE: I know. I agree with you. I am not disagreeing. Therefore, we have a big fine for that

harm.

COMMISSIONER MacKINNON: That is potential harm, I said.

MR. MOORE: Well, if we want to look at what the harm is that they are planning to do, if they conspired to violate a parking meter for $5, then the fine is only going to be $5. It doesn't matter if it is two of the biggest corporations. The only harm they did was violate a parking meter.

COMMISSIONER MacKINNON: The other thing I understood you to say is that you didn't want to get into imposing too much cost on corporations in monitoring offenses. Is that right?

MR. MOORE: One has to think about why one should fine a corporation at all. After all, it is individuals that commit the crime. It is an individual who commits fraud or an individual that in fact dumps toxic wastes in the river, or whatever.

COMMISSIONER MacKINNON: But corporations benefit from the actions of individuals.

MR. MOORE: Exactly the point. And even if the corporation didn't sanction it, they may benefit, so you want the corporation to oppose this kind of behavior by its agents. Therefore, you want to have them

monitoring their agents, their employees, to make sure their employees don't do that and to instruct their employees not to do that, because it is not in the corporation's interest for them to do that. That is why you want to fine corporations. So monitoring of their agents is a important element of that.

COMMISSIONER MacKINNON: But you said that you didn't want to overmonitor them.

MR. MOORE: You don't want to have them spending all their time watching their agents so their agents haven't time to produce cars and refrigerators and the goods and services that we need in society. One can waste resources by spending too much on something as well as spending too little.

COMMISSIONER MacKINNON: Let me tell you from actual experience that the cost of monitoring offenses can be very minimal in comparison to the ultimate cost that may result to you if you don't do it, and particularly in large corporations and particularly in the securities field. If you don't overmonitor, according to your standard, you are going to be in a position where your civil penalties that result are going to be so far in excess of what your cost of monitoring would have been that it wouldn't even be

funny.

MR. MOORE: I think, then, you would want to have those monitoring costs and they would not be overmonitoring, they would be the appropriate monitoring. If you faced very high civil penalties in the fraud or the securities area, you would want to carefully monitor your employees. That is, an appropriate deterrence fine system will generate the right incentives so the corporation will spend the right amount of money on monitoring its employees, to make sure they don't violate the law.

COMMISSIONER MacKINNON: I will also tell you that at that time when you do that they will tell you that it is overmonitoring. But it isn't.

MR. MOORE: I am not interested in what the public relations departments of corporations will tell you. Of course they are going to tell you that they want lower fines, they want --

COMMISSIONER MacKINNON: I am not talking about public relations. I am talking about the general counsel.

That is all I have.

CHAIRMAN WILKINS: Thank you. Mr. Gainer?

COMMISSIONER GAINER: Dr. Moore, a few

moments ago, in response to Judge MacKinnon, you made the statement, "I am not a lawyer." I had the impression you said that more out of a sense of pride than a sense of apology. (Laughter) In my experience, economists tend to think that lawyers can't think logically; conversely, lawyers tend to think that economists can't feel. (Laughter)

I think, as a whole, lawyers are very circumspect about the potential value of the contribution that economists can make in the field of criminal justice. I know of only one exception to that and that turned out to be illusory. About ten years ago a meeting was held at the Department of Justice, a conference on the contributions of economics to criminal justice, and it was attended by a number of economists. The then Deputy Attorney General said that he was absolutely delighted to see the economists turning their attention to the field of criminal justice. Anything, he said, to keep them out of the field of macroeconomics. (Laughter)

With an attitude like that, I think you can well understand that lawyers are going to tend to be circumspect about any approach that is loss based, simply because lawyers tend to think of losses in terms

of monetary loss.

From your testimony here today, it's very apparent that you are not so limiting. Your interpretation of loss. By extrapolation, I would presume that the Council of Economic Advisers Working Group or the Domestic Policy Council similarly had in mind a broader interpretation of loss.

MR. MOORE: That's correct.

COMMISSIONER GAINER: Judge Breyer had questioned whether or not in some respects your proposal might in essence be akin to a civil system as opposed to a criminal system. Yet in your testimony you do tend to emphasize such difficult-to-assess factors as affront to society in your bribery hypothetical, indicating there are all sorts of losses that do go into the meld of determining what is the total loss for purposes of computing an appropriate sentence.

Given the great difficulty of identifying all the kinds of losses that occur as a result of particular kinds of criminal offenses, and given further the difficulty of attempting in any quasi-intelligent fashion to quantify those losses, I was curious as to whether the Council of Economic Advisers might be able to offer to work a little more closely with the

Sentencing Commission in the future, perhaps at a staff level, in assisting in trying to identify all the kinds of social losses that do occur in consequence of various kinds of criminal offenses, and provide some guidance as to how the Commission might attempt to go about quantifying those kinds of losses, whether or not the Commission takes what might be viewed as a fairly pure economic approach to sanction or whether they take quite a different approach based upon justice or based upon necessity of deterrence, but predicated upon assessment of loss. It is going to need information of that kind. It is going to need to be able to identify the various forms of loss and the magnitude of those various forms.

Is there any way that Council might be able to provide some assistance in the future? I think it would be quite welcome.

MR. MOORE: It would be happy to help to the extent we can. We do have very small staff, but we would be willing to do our best to help.

CHAIRMAN WILKINS: Thank you very much, Dr. Moore. We appreciate not only your attendance but obviously your great deal of thought and work that went into your testimony prior to your presentation today. We would welcome a working relationship with you, and I

am sure will be calling upon you again.

MR. MOORE: Thank you very much. Did you get my testimony?

CHAIRMAN WILKINS: Yes, we did. Thank you very much.

(Witness excused)

CHAIRMAN WILKINS: Our next witness is Mr. Sam Buffone.

S A M B U F F O N E, called as a witness, stated as follows:

CHAIRMAN WILKINS: Mr. Buffone is a partner in the law firm of Asbill, Junkin, Meyers & Buffone. Mr. Buffone has testified and worked with the commissioner in other areas prior to today, and as a representative of the American Bar Association, I might say, on many occasions.

Mr. Buffone, we are delighted to have you and look forward to your testimony and continued working relationship with you and the American Bar Association.

MR. SAM BUFFONE: Thank you, Chairman Wilkins, members of the subcommittee. I would like to introduce William Brodsky. Bill, like myself, is an admitted lawyer and a member of the ABA's Committee on

the Sentencing Commission. Bill and I are the two members of the ABA's committee who also serve on the American Bar Association's White Collar Crime Committee. Accordingly, we have looked closely at the question of organizational sanctions. Bill testified and presented testimony to the Commission on the issue of organizational sanctions during your initial round on the first set of guidelines.

CHAIRMAN WILKINS: Glad to have you back.

MR. BRODSKY: Thank you, sir.

MR. BUFFONE: As the Commission is aware from our past testimony, the position of the American Bar Association is founded on our criminal justice standards. We were pleased to see that the Commission chose to include, as part of its discussion materials, that portion of the standards that deal with organizational sanctions.

I would like to begin by offering my sincere compliments to the Commission for the way you have chosen to approach the issue of organizational sanctions. During my last testimony I expressed some concern over the openness of the Commission's process. I no longer have any reservations. The Commission deserves to be complimented over not only holding these

hearings and the forthcoming hearings in Los Angeles, but the very manner in which you presented this issue to the public in the form of Draft Guidelines, with detailed explanatory materials setting forth the basis for much of what is in the guidelines. This has permitted us to focus our comments and I think will permit the Commission to reach a much more reasoned decision. We compliment you again on this and encourage you to do the same in the future. We are hopeful that what will come out of this process will be a more refined set of guidelines that will be submitted to a second round of public comment to permit the Commission to fine-tune its guidelines and, if necessary, to make radical changes in them.

We generally support the position expressed in the Draft Guidelines because of its overlap with our criminal justice standards. That overlap is in three significant areas:

First, the Commission appears to favor the ABA's range-of-sanctions approaches, and we understand that much of this is dictated by the Sentencing Reform Act. We view the range-of-sanctions approach as the most critical component of our policy on organizational standards.

Second, we note the overlap between our standards and your Draft Guidelines on the need for coordination of civil, administrative and criminal sanctions in this unique area.

Thirdly, we support your efforts to bring predictability, uniformity and substantial sentences to the area of organizational criminality.

We do, however, have reservations, and those reservations are significant.

We note that you have drafted specific guidelines without the data base that was available to you in the area of individual guidelines. We question the ability of the Commission to formulate specific guidelines based on the new sanctions available under the Sentencing Reform Act and the enhanced penalties brought to old sanctions without the empirical data base to enable you to draw on past practice.

We have reservations about the Commission's reliance on the loss-base optimal-penalty theory, and the Commission's reliance on a philosophical or economic model of a determinant sentencing system for organizational sanctions.

Finally, we have strong opposition to the use of any arbitrary multipliers as a means of arriving at a

fair or just fine, restitutionary, or other monetary sanction.

What we favor is, rather, as our criminal justice standards do, a set of flexible guidelines that would permit the Commission to carefully monitor experience of the federal courts as they applied the new sanctions, the enhanced sanctions formerly available to them, and develop a data base of how judges in real-world situations are dealing with these new penalties. After you have a data base move slowly towards more structured guidelines, we certainly think that there is a need for guidelines, but would favor guidelines with far more flexibility than we see in the draft that was presented to us.

We have posed a series of questions that we have attempted to answer in our written testimony. I would like to briefly go over those questions and, even more briefly, the answers, and I will rely on a written submission.

First, does the Commission's use of economic analysis through its optimal penalty theory provide the necessary basis for adoption of the loss base approach to the guidelines?

Is there a sufficient philosophical and

empirical data base to permit you to adopt a theoretical model that will drive each and every one of your determinant sentencing guidelines?

Has the Commission adequately considered the potential objectives of punishment, deterrence and rehabilitation in the unique circumstances of organizational sanctions?

And I can pose that: Have you too much relied on deterrency to the elimination of those other two needs of criminal sentencing as recognized by the Sentencing Reform Act?

Should the offender characteristics of the organization be given greater consideration?

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 the lack of disparity?

Is the Commission's use of a multiplier for fines appropriate, and is it possible to quantify enforcement costs in probability of detection?

Should the Commission issue specific guidelines on plea bargaining regarding organizational sanctions?-- an issue I addressed a few moments ago.

Would the proposed guidelines result in

unnecessarily complicated fact-finding by the sentencing courts?--an issue that we particularly feel deserves further attention by the Commission.

Should the guidelines address in more detail an enforcement mechanism? I note Judge Wilkins' comment on the contempt power earlier.

The Commission is familiar with the ABA standards and I won't go into the standards in any great detail, other than to say that they do largely overlap with many of the decisions that apparently underlie the Draft Guidelines.

The only significant variance that I see is the inclusion of a disqualification-from-office sanction as part of our guidelines, although I understand that that is an individual sanction but one that we feel should be considered in the mix of organizational sanctions.

When we asked the Commission to reexamine the basic principles of its loss-base approach, we looked particularly at the paper offered by Jeffrey Parker that we interpreted as providing much of the theoretical underpinning for the Draft Guidelines. There is there the adoption of the optimal-penalty theory with its reliance on economic analysis and a deterrency-based

model. Our analysis of the first set of guidelines for individuals, the set ultimately promulgated by this Commission, was that the Commission quite wisely determined that it would not adopt a single philosophy of sentencing; the commentary stated that the Commission did that purposefully; that it instead relied upon its 10,000-case data base in providing an empirical basis to draw upon past practice; that it didn't feel the need to come up with a unifying philosophical basis to project ultimate sentences.

We sense in the Draft Guidelines that the Commission has done just the opposite, and you have chosen the theory and then let that theory drive each and every one of your determinations. We question whether or not the theory holds up in the real world of corporate sentencing and the need for organizational sanctions.

We urge the Commission to not adopt such a rigid approach towards a theoretical basis but rather to adopt, as it did with the initial guidelines, a more flexible approach that draws upon existing evidence and components of all of the models of criminal sanctioning that are available for the Commission's study to draw strengths from those where the strengths lie.

We urge the Commission to adopt a greater emphasis on offender characteristics for organizations. The data available to the Commission indicates that only a very small percentage of organizational sanctions are imposed upon major corporations. The Draft Guidelines do not permit consideration of unique offender characteristics for either those very large corporations or for very small corporations.

We cite in our testimony several examples of how offender characteristics perhaps might become more relevant. One is a national corporation involved in a variety of activities on a nationwide basis, if it is found guilty of a criminal offense through the application of vicarious liability based upon the acts of a menial employee. Applying a mechanistic fine schedule to what may be a great loss would not have the same deterrent effect on corporate management as perhaps a more structured penalty of corporate intervention, without an analysis of the organizational structure, the participation of the management in wrongdoing, or whether or not the management even had the ability to monitor the wrongdoing or turned their back on it. We urge flexibility in the application of sanctions for those types of situations.

An additional example is a corporation that provides important national defense products or services or is engaged in critical research in an emerging technology. Those are the kinds of externalities that perhaps should be considered as part of the sentencing process.

We urge the Commission to adopt a position that will provide for enhanced judicial discretion. As we read the Draft Guidelines, the sentencing court is limited to applying its discretion within the range of the guidelines or through the departure standards. Given the detail in which the Draft Guidelines address this area, it is going to be very difficult for a judge to depart. The departure standard has little applicability to an area such as this where we don't have past experience. Either we need a new departure standard that would give broader flexibility for organizational sanctions or more flexibility at the initial point of the sentence determination.

Based upon our criminal justice standards, we reject any multiplier. The standards take the position that any in terrorem or multiple penalty should not be applied. We take the position that the limit on monetary sanctions should be the uppermost of the gain

or loss. We believe that excessive monetary penalties are counterproductive; that there may be a prosecutorial reluctance to seek excessive penalties; the plea bargaining process may erode the penalties; that there is an ultimate pass-through to consumers, and that other sanctions offer sufficient deterrence. Most importantly, we believe that adequate civil and administrative remedies should be relied upon where they are in fact effective. We urge the Commission to issue specific guidelines on plea bargaining practices for organizational sanctions. It is our belief that Chapter 6 of the guidelines that addresses plea bargaining currently does not adequately take into consideration the unique realities of plea bargaining in organizational and white collar cases.

There are considerations in plea bargaining that are far different from those present when you are bargaining over an individual sentence. The profitability or amount of corporate reserves may affect a corporation's willingness to make a wholly business-driven decision about whether or not to enter into a plea bargain because of their corporate reserves or high profitability, whereas an individual, fearing incarceration, would not be motivated by that kind of

economic determinism.

There is a unique tendency, as any prosecutor or white collar practitioner will tell you, to protect the individual. As in most organizational cases, if you have a parallel indictment of a corporate officer or corporate employees, the plea bargaining process is often driven by a desire on the part of the prosecutor to have some penalty for the individuals and a desire on behalf of the corporate defendant and the defense attorneys to shield the individuals. That results in an inordinate focus on the corporation as the repository of the punishment.

We think that plea bargaining guidelines should address that issue and provide some guidance as to how the guidelines should be applied in that unique circumstance.

Past practice in white collar plea bargaining indicates that some penalties, such as debarment from government contracts, significant penalties from ancillary civil and administrative proceedings, and oftentimes a lack of government coordination in its enforcement efforts create real problems in the plea bargaining process and problems that should be considered by the Commission in formulating guidelines

on plea bargaining.

We urge the Commission to consider what we believe is a very complicated fact-finding mission that a District Court would have to undertake under the Draft Guidelines. Determinations of value of loss, costs of enforcement, risk of detection, all factors that will be extremely difficult for a court to quantify and, under prevailing constitutional standards, a court will have to engage in fact-finding in order to reach a reasoned decision on each and every one of those vague standards. We fear that the Draft Guidelines would result in sentencings that would consume unnecessary judicial resources.

Finally, and as a minor comment in light of our others, we urge the Commission to issue discussion materials in the form of broad commentary on enforcement mechanisms. If the Commission is to adopt any form of corporate intervention, be it called probation or some other sanction, then we believe the Commission should address, as some of the discussion materials have, what the Commission believes is the appropriate range of sanctions for District Court.

Now, I understand that the Commission is reluctant -- and I would agree with that reluctance --

to tread into areas of judicial administration and questions more properly left with the judiciary. But I feel that the Commission's wisdom on this issue could be imparted by some very broad commentary on how you view the task of the District Court in enforcing appropriate sanctions.

I appreciate the opportunity to testify, and we are prepared to answer any questions you might have.

CHAIRMAN WILKINS: Thank you very much. You mentioned coordination of criminal and civil assessments. How can those be coordinated?

MR. BUFFONE: I agree with almost everything Judge MacKinnon said. I understand this is a very difficult question. The way the criminal justice standards parse the question is to say that where there is an adequate mix of civil and administrative remedies there should be deference to those remedies. I understand that that is going to oftentimes create a dilemma for a sentencing court that the administrative or civil cases may only be beginning and be far from resolution at the time of the criminal sentence. But we think, in terms of ultimate deterrency and fairness, that there should be reliance on those processes rather than the criminal law as the sole determinant of the

monetary sanction.

CHAIRMAN WILKINS: What is your position on restitution in relation to the criminal fine? Should it be deducted from the fine or should it be paid in addition, whatever the appropriate fine is?

MR. BUFFONE: Deduction may be too strong a word, but we believe there should be careful coordination. And given that many plaintiffs do not have the financial resources to hire private attorneys and enforcement priorities that the Department of Justice might need and that civil cases are never brought, restitution is going to play a very important role and should be a remedy of choice.

CHAIRMAN WILKINS: It should be coordinated but not deducted?

MR. BUFFONE: A deduction may often be the result, Chairman Wilkins, but I can see cases where you might not want a dollar-for-dollar deduction because a criminal fine would have goals that were in addition to that of restitution. So you might want a fine that is greater than restitution. If you are capable of calculating on a dollar-for-dollar basis, fine, deduct. I don't think that is always going to be possible.

CHAIRMAN WILKINS: I am going to ask you on

plea negotiations if you would develop your good ideas into concrete proposals so that we may study them in the concrete as well as in theory, if you have an opportunity. It would be very helpful for us. I know many of the guidelines are so written because a witness provided concrete proposals that we adopted.

MR. BUFFONE: Not only will we be happy to undertake that, Chairman Wilkins, but we plan to. You have certainly given us enough time to formulate our positions, but due to internal situations, we were unable to reach consensus on a plea bargaining process, and that is a process on which my committee intends to submit additional comments to the Commissioner.

CHAIRMAN WILKINS: We all appreciate the consensus-forming procedure.

Let me ask if there are any questions to my right.

COMMISSIONER BLOCK: I have one question. Mr. Buffone, I appreciate the observation that we lack the observations on which to construct an empirically based set of guidelines. I want to follow up your suggestion, because I am somewhat confused. You made a suggestion that we ought to go slow, which sounds reasonable, but we ought to then look at the system as

generating more empirical information upon which we might base more specific guidelines. I guess I am confused by the general tenor of your comments about how we would extract anything from that. Let me be more specific, there being at least two major changes in the fine laws dealing with organizational offenders since 1983. How would we extract information from observations on individual sentences over the next several years to use in the construction of a set of guidelines?

MR. BUFFONE: Commissioner, I think that organizational sanctions, while they present many thorny issues, also are an opportunity for the Commission, because you are dealing with such a small number of cases. I think you really could, in this area, request the District Court judges and work with the Judicial Conference to draft opinions and detailed explanations of reasons for every sentence that is imposed on organizations. We do have new remedies, enhanced fines, which every person, every organization that looked at this problem, uniformly said that we needed, higher fines. We have for the first time the remedy of proactive corporate intervention that hopefully will be used, and used in appropriate circumstances. We have

the Commission's guidance already in the Draft Guidelines and I would expect even more detail on how that mix of remedies can be applied. I would like to see federal District Court judges given the opportunity to use these new remedies and enhanced remedies in real-world factual situations and then have the Commission deal with that limited number of case studies and make determinations about whether or not there is disparity, whether or not the ends of sentencings are being served and whether or not there is overall fairness in the system.

COMMISSIONER BLOCK: How would we know that the ends of sentencing would be served. I don't even know about the disparity, but how would we know from the diffuse discussion that you have given us that the ends of sentencing will be served? It seems to me very hard from the hand waving that we know anything about punishment or rehabilitation. How would we be able to judge whether the ends of sentencing are being served?

MR. BUFFONE: I think we are going to have several benchmarks. One is the administrative and civil actions will come to their end, and you will be able to compare what fine would have been imposed under a set of guidelines, what fine was imposed by a judge against an

ultimate civil law determination of what loss was. You will have information, although it may take longer to generate, on recidivism, and have these practices continued after the criminal sanction?

Most importantly, I think we are looking at the remedy of probation and how is that going to work? Are we going to find that imposing sanctions such as requiring corporate management to engage in increased oversight of employees to change the flow of information to the board of directors or executive committees who are charged with routing out corruption in the corporation, are those remedies going to work? Is the information going to be generated? Is corporate management going to come back and say this really was a very effective process and one that we intend to continue? I think that information, although it is not going to be of the precision that perhaps the Commission would like, is going to be available and is going to permit you to make a much more informed decision in his this area.

COMMISSIONER BLOCK: Thank you.

CHAIRMAN WILKINS: Ms. Corrothers?

COMMISSIONER CORROTHERS: Mr. Buffone, do you feel that because of the limitation concerning current

practice data that we should consider initially developing policy statements as compared to guidelines, and that concurrent with the implementation of the policy statements we should establish a data collection system that would ensure gathering of information on current practices which would of course lead to guidelines? Or do you feel that the paucity of current practice data should not deter us from moving ahead with the development and promulgation of guidelines as long as they are, in your words, more flexible?

MR. BUFFONE: I come down somewhere in the middle, Commissioner, but closer to your first question. We believe that there should be some guidelines, but the guidelines should not be as determinant as the Draft Guidelines. They should provide broader flexibility to the sentencing court. We think that there is enough here that the Commission can formulate some guidelines if they are flexible and permit the District Court to deal with the range of sanctions, consider offender characteristics, and have overall more flexibility in sentencing process.

COMMISSIONER CORROTHERS: And then, as more experience is gained and more information becomes available, those guidelines would become firmer or

narrower?

MR. BUFFONE: We would expect the Commission to periodically revisit those guidelines as data becomes available, and at the end of this process we would wind up with a very fixed set of guidelines, much like we have for individual sentencing now.

COMMISSIONER CORROTHERS: Thank you.

CHAIRMAN WILKINS: Ms. Nagel?

COMMISSIONER NAGEL: No.

CHAIRMAN WILKINS: Judge Breyer?

COMMISSIONER BREYER: I think that your basic point is to make these guidelines something like policy statements and make them far less detailed in containing rules for calculating loss, etc.

MR. BUFFONE: That's correct.

COMMISSIONER BREYER: The other thing I wonder is, why are corporations prosecuted? You defended them. If I could get very clear on that, I think I would have a better idea of what direction to go. There is a crime that has been committed.

MR. BUFFONE: There is an answer to that, Commissioner, and it is: Someone said, in commenting on the first witness, that individuals commit crimes, not corporations.

COMMISSIONER BREYER: Yes exactly.

MR. BUFFONE: Well, I think organizations do commit crimes. There are organizational personalities. There are group decisions that are made. While we do have instances of the rogue employee who goes off and fixes prices in a remote section of the country by himself, we also have corporations that make joint premeditated decisions about how they are going to react in the marketplace. And those decisions might be business motivated decisions that they are going to engage in criminal conduct or at least assume the risk of criminal conduct. That kind of organizational behavior should be dealt with through sanctions tailored to the organization.

COMMISSIONER BREYER: Why shouldn't you punish the individuals who make it?

MR. BUFFONE: Excuse me?

COMMISSIONER BREYER: Why shouldn't you punish the individuals who make it?

MR. BUFFONE: I think you should, and one of the sanctions that the ABA favors is disqualification from office.

COMMISSIONER BREYER: Well, fine the individuals. I mean, someone made that decision. The

organization couldn't have made it without an individual being involved.

MR. BUFFONE: Mr. Brodsky has a comment.

MR. BRODSKY: Judge Breyer, sometimes the prosecutor cannot get enough evidence in a criminal sense against any particular individual, but because of the actions of a group of individuals, the organization is clearly culpable.

COMMISSIONER BREYER: I see.

MR. BRODSKY: For example, there was a case recently involving a law firm that engaged in tax shelter violations, they were backdating documents, and a variety of fraudulent activities were committed. The law firm was indicted. No individual law partner was indicted, but every partner in the firm had in fact benefited from the activity that the firm engaged in. And I believe that one of the reasons the prosecutor may have chosen to indict the firm and not any one individual or two was that the ability of witnesses to ascribe particular actions to any one individual was fuzzy, and yet the activity was clearly carried on by a representative of the entity.

COMMISSIONER BREYER: That is interesting. I also found very interesting in your paper your

discussion of numbers. You pointed out that we are talking about a very, very small number of cases; that there are 40,000 criminal defendants a year, and evidently about probably 300 of those are corporations. Then you said, of the 300 corporations, only 10 percent are mentioned in Standard & Poor's; and, of those mentioned in Standard & Poor's, only about 10 a year are publicly traded corporations. So we are talking about 10 cases out of 40,000 if we are talking about publicly held corporations.

That suggested the following question in my mind: If most of these cases, indeed the vast number -- we are talking about only three-quarters of 1 percent of all the defendants -- if the vast number of that three-quarters of 1 percent are companies that aren't even in Standard & Poor's, maybe there are companies where the individual criminal defendant owns the company. If that is so, perhaps they are instrumentalities of the crime. If they are instrumentalities of the crime, perhaps they should be dissolved. Or maybe there is another set of instances where the criminal defendant uses the corporation for some wicked and some good purposes, but there are not innocent partners involved. Then maybe we have another

objective there. Maybe what these guidelines are talking about is really best thought of in respect to this very small number of cases involving large publicly held corporations, which are about four a year or ten a year.

MR. BUFFONE: It is an extremely complex problem. I am sure you are familiar with the experience the federal courts have had in sorting through the RICO statute where we look at those very questions of: Is the enterprise one that has been corrupted or part of the corrupt activities? And the federal courts have available to them a range of sanctions to deal with the effects on the enterprise that can often result in effectively destroying the enterprise, which is the purpose of the criminal law.

The organizations that are left at the very top of your declining number of cases nonetheless present very significant problems for criminal law enforcement and unique problems for criminal sentencing. We look at the newspaper accounts now of the potential for RICO prosecutions against major financial houses, and millions and millions of dollars in potential losses, according to the newspaper accounts. When we try to factor into the Draft Guidelines how a case of

that complexity and enormity would be dealt with, I don't think we we get satisfactory answers.

COMMISSIONER BREYER: If in fact we are now thinking of that set of cases, which may be a very, very small number but nonetheless important, the set of cases where we are talking about a publicly traded corporation, so there are many innocent shareholders, in quotes, but I mean they are not directly involved, then we are talking about officers who may, in a sense, be guilty but we know each is pointing to the other so we don't know whom to prosecute. If that is the group that we are thinking of, is there a purpose to a criminal penalty other than to get that kind of company to have internal controls of a superior nature with respect to its management? I think that that is what is to be said for this draft: It is focusing on that instance, perhaps a small number, but it is focusing on that, and it says our basic purpose in punishing that kind of corporation in that kind of instance is to get that kind of corporation in that kind of instance to have better internal checks on its management. There may be other purposes as well, and if there are, I want to get to those.

MR. BUFFONE: I think the point of agreement,

Commissioner, is that that should be the end of the sentencings.

COMMISSIONER BREYER: Yes.

MR. BUFFONE: And we don't think in that situation a monetary sanction --

COMMISSIONER BREYER: -- is the only one.

MR. BUFFONE: While it may be appropriate, it is not the most important. What you focused on is going to be the most important sanction to appropriate punishment to make sure that the action is not going to occur in the future.

COMMISSIONER BREYER: You see that is the end?

MR. BUFFONE: Yes.

COMMISSIONER BREYER: That is our objective?

MR. BUFFONE: Yes.

COMMISSIONER BREYER: That is our objective; we don't have some other important subsidiary objective?

MR. BUFFONE: No.

MR. BRODSKY: I fully agree. I think one of the reasons historically prosecutors have not brought charges against corporations is that you can't send the corporation to jail. The sanction is viewed as not being sufficiently meaningful to be worth the cost of

investigation, the cost of prosecution, because you will be met with a bevy of very well-healed lawyers, and what happens at the end? A mail fraud is a thousand dollar fine -- it has been in the past.

So these factors that we talked about as to the policing of the internal practices of the corporation are very important.

You want to deter. In my mind, deterrence in a corporate environment comes more from making the environment at the top one that calls out for law enforcement rather than, as in some corporations recently, creating an atmosphere where lower-level employees feel that it would be welcomed by its higher-ups to cheat or bribe or get the extra percentage point by kiting money, things of that sort.

COMMISSIONER BREYER: That is helpful. Thank you.

MR. BUFFONE: Just one final comment. We do intend to submit further coments on plea bargaining. That is part of the process that Bill alluded to. Often in indictments in white collar cases the plea bargaining process begins perhaps even prior to the grand jury being convened, and there are considerations of potential civil suits, effects on individuals, remedial

actions, that the corporation may engage in by itself in order to head off the investigation, such as employment of inside counsel to monitor the corporation, changes in corporate monitoring. This is a unique area where plea bargaining and prosecutorial decisions have an impact on remedial actions that may be taken before the criminal process ever runs its course.

CHAIRMAN WILKINS: Any other questions?

COMMISSIONER MacKINNON: Pursuant to what authority would that come about? What would be the authority to impose something prior to a criminal prosecution?

MR. BUFFONE: Oh, I am saying, your Honor, that the corporation would do it itself. In the situation I am thinking of, a corporation would be given notice that it was under investigation, let us say, for price-fixing. Corporate management would bring in independent counsel, conduct an investigation, determine that there might be a problem, and institute remedial actions on its own, perhaps change the way it reviews data from the field, discipline employees. And those kinds of internal decisions might be of significance to the prosecutorial authorities.

Now, we are thinking here primarily of the

experience of the Securities and Exchange Commission -- I know you are going to hear from them later this morning -- and the Federal Trade Commission. We drew heavily upon those two agencies' experience in our criminal justice standard, and I noted that the Draft Guidelines also refer to them, the commentary -- the use of the flexible procedures of those two agencies, use of consent decrees, and other methods of involving the corporation in its own housecleaning, oftentimes internally of its own volition, of its own choice and with the active consent of the corporation, is what I was referring to.

COMMISSIONER MacKINNON: Do you think that is an alternative to the United States Attorney?

MR. BUFFONE: No, sir. I believe that experience proves that many of those actions would not have been undertaken without the prod of an investigation; that you certainly need someone out there making sure that they are sincere, that the internal remedies are going to be effective, and that may often still require a criminal prosecution or a civil suit.

COMMISSIONER MacKINNON: Were you referring to Hutton, for instance, where separate counsel was employed?

MR. BUFFONE: I was not, but I know that is a case that Mr. Brodsky and I referred to, and I think his earlier reference to check kiting was.

COMMISSIONER MacKINNON: Did they come out with any individuals there?

MR. BRODSKY: No, sir.

COMMISSIONER MacKINNON: It was entirely a corporate matter, wasn't it?

MR. BRODSKY: Yes, your Honor.

COMMISSIONER MacKINNON: As I recall it.

MR. BRODSKY: There was some indication that some of the problems of the investigation involved giving of immunity to so many people early in the investigation that there was no one, in effect, left to prosecute on an individual basis.

COMMISSIONER MacKINNON: But there were a number of individuals that were targeted.

MR. BRODSKY: I believe so, your Honor.

COMMISSIONER MacKINNON: It must have been or you wouldn't have given them immunity.

You said that you thought that they ought to be given a range of sanctions, like receivership, dissolution, disqualification. Are those the things that you were talking about?

MR. BUFFONE: No, sir. The range of sanctions is primarily monetary. The range of sanctions that we favor are restitution, fines, forfeiture, disqualification from office, and some form of limited corporate -- "judicial oversight" is the terminology that the Standards use.

COMMISSIONER MacKINNON: How about, then, about receivership and dissolution?

MR. BUFFONE: We take a position in our testimony, your Honor, that we do not favor those kinds of radical remedies; that any judicial intervention should be carefully crafted and of a limited nature.

COMMISSIONER MacKINNON: Wouldn't you in the exceptional case -- they are used sometimes, you know -- wouldn't you think in a exceptional case they might be used?

MR. BUFFONE: I would think in a truly exceptional case, your Honor, there well might be the need for that kind of aggressive corporate intervention, but as a general matter I think it should be reserved for the truly exceptional case.

COMMISSIONER MacKINNON: How about disqualification from government purchases or government contracts?

MR. BUFFONE: Debarment is an available remedy now, and I am stating my personal view now, not that of the American Bar Association -- one that perhaps is not used as effectively as it can be. It is a sanction that drives a spear into a corporate executive and, if used appropriately, could be an extreme deterrent.

COMMISSIONER MacKINNON: Should we put it in our guidelines? And what authority would we have to put it in?

MR. BUFFONE: I think it should be considered under a plea bargaining guideline to make it clear that this is one of the potentially other adequate remedies that is available and should be considered by a judge -- is there going to be a debarment proceeding? Has there been debarment?--before he reaches a determination of what an appropriate monetary sanction is.

COMMISSIONER MacKINNON: Would the party have to agree to it as a condition or could it be imposed?

MR. BUFFONE: I think it could be imposed but not by the court; by the agency who has authority over the contracting procedures.

COMMISSIONER MacKINNON: You do not think it ought to be available to the court?

MR. BUFFONE: Again, this is my personal opinion, not that of the American Bar Association, no, I don't think it should be. Because if we are looking at an area such as defense contracting, the unique concerns of the Department of Defense and its knowledge of its internal contracting process I think should be given primacy over federal judicial intervention in that area.

COMMISSIONER MacKINNON: Where does RICO come in, in the ABA view?

MR BUFFONE: It doesn't, other than my observation, your Honor, and it is just that I think one of the prosecutorial realities of today is that there is increased use of RICO. We have scheduled a panel at the next gathering of the White Collar Crime Committee of the American Bar Association on increased use of RICO in corporate cases. We are beginning to see that RICO is being used not only in organized crime cases but criminal RICO is being used in white collar corporate cases.

COMMISSIONER MacKINNON: Thank you.

CHAIRMAN WILKINS: I take it that you would recommend that we issue policy statements which carry weight of authority but in the final analysis are advisory in nature, and monitor the corporate sanctions

over the next few years before we issue guidelines. Is that a correct statement?

MR. BUFFONE: I am not trying to split hairs, but I think we go a step further than that. I think there could be some guidelines instructing a judge that you should impose a restitutionary remedy if there is loss that is compensable. Those kinds of guidelines would still provide flexibility but would not provide unlimited discretion to judges and would make them go through a structured process.

CHAIRMAN WILKINS: Mr. Buffone, Mr. Brodsky, thank you very much. We look forward to your continued work and relationship with the Commission. Thank you.

(Witness excused)

CHAIRMAN WILKINS: Our next witness is Mr. Lynch.

Mr. Lynch, we are delighted to have you with us.

G A R Y L Y N C H, called as a witness, stated as follows:

CHAIRMAN WILKINS: Mr. Lynch is the Director of the Enforcement Division of the Securities and Exchange Commission.

We will be glad to hear from you, Mr. Lynch.

MR. GARY LYNCH: Thank you, Chairman Wilkins.

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. The views that I will express are my own, and do not necessarily reflect the views of the Commission or other members of its staff.

I also have another caveat. 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. Attorneys' offices on criminal prosecutions which they have initiated, and my role in this process has also shaped the views that I will express.

I would like to address some of the assumptions underlying the guidelines which appear to embody an essentially economic approach to criminal

sanctioning. 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.

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 the offense loss measures society's interest in controlling the criminal conduct, and thus provides the basic measure for determining a sentence. However, it is my view that 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, at least as it was reflected in the Draft Guidelines, 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, less

readily quantifiable, injury to society. The proposed guidelines, however, will tend to treat all claims as inherently equal -- differing only in the loss that 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, either 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. Certainly a system of sanctions that relies upon a similar calculation to deprive those kinds of 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 that 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 or organization 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. To the extent that a system of sanctions is to be developed, it is imperative that guidelines be crafted which will ensure that penalties are sufficient to deter violations and to counter this public perception of undeserved leniency. In this regard, I am pleased to see the Guidelines specifically state that forfeitures required by 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 2. This multiple could be increased up to 3 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 1, 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 inside 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. In addition, the Guidelines will intertwine criminal and civil cases in a way that would needlessly complicate both.

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 difficulty with this position 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 simply 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 well may 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.

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.

I thank you again for providing me the opportunity to express my views, and I will try to answer any questions you might have.

CHAIRMAN WILKINS: Thank you very much for your interesting and informative testimony.

As I understand it, you would urge this Commission to issue guidelines, if we come to that point, that provided for the imposition of criminal sanctions which were not affected by civil assessments which had been or might potentially be imposed in the future.

MR. LYNCH: Well, certainly I wouldn't recommend adoption of guidelines that wouldn't permit a court, the ability to consider the moneys that have been

paid in civil actions or penalties in administrative actions. But I would not also favor guidelines that required a court to treat those civil moneys paid as offsets for criminal fine.

CHAIRMAN WILKINS: The question is, leave it up to the individual judge and individual case?

MR. LYNCH: I think it should be up to the judge. The judge should have the flexibility to consider not only the amount of money paid but the other remedies for sanctions that were levied in civil or administrative actions.

CHAIRMAN WILKINS: What we are about with respect to guidelines is that, regardless of the luck of the draw on the assignment of the judges, each corporation be treated in a similar fashion. If we allowed that, we might have disparity in imposition of sanction. It is a difficult question. Either you have the two systems merge or one affect the other, or you have them separate.

MR. LYNCH: Couldn't you have guideline statements or policies that delineate factors that the court should consider in determining what the appropriate sanction should be, including the amount of money that should be paid and how those moneys relate to

the profits that were realized by the corporation or losses that were caused, and also deal with a number of the other factors that I mentioned, such as what the corporation or organization did once the conduct was detected, did they take effective remedial action?

CHAIRMAN WILKINS: Thank you very much. Let me ask if there are any questions to my right. Mr. Block.

COMMISSIONER BLOCK: Mr. Lynch, I just want to follow up on this notion of a just punishment and take for the moment the small number of what I submit are important cases where we have publicly traded companies, large companies. What really is the difference there between this just punishment approach, which I must say I don't have a very good idea of with respect to what it means when applied to corporations, but what is the difference, in your view, between this just punishment approach and some sort of deterrence-based approach in terms of fines? Focus on the large corporations now, not closely held, but large publicly traded corporations.

MR. LYNCH: I don't think a just punishment approach is inconsistent in any way with a deterrence approach. I think those are two factors that you have

to consider in coming up with the appropriate criminal sanction, but I don't believe they are inconsistent in any way whatsoever.

COMMISSIONER BLOCK: But let me get the two-factor thing straight. I want to get from you your view of what the function is of criminal sanctions for these large publicly traded firms levied on the organizational firms. What is the function of organizational fines?

MR. LYNCH: I think the primary function is deterrence, so that other corporations that are similarly situated won't engage in similar conduct. But I also think it is important that whatever sanction be levied might not only have an effect on other corporations who are similarly situated, but that to the citizenry as a whole those sanctions be viewed as just and appropriate, given the nature of the conduct.

COMMISSIONER BLOCK: Let me trace that out a little bit, because that seems easier to say than to implement. You are not suggesting that fines be denominated as, say, 10 percent of capital value?

MR. LYNCH: No.

COMMISSIONER BLOCK: And that would certainly deter. So you are not suggesting that we deter at any price.

MR. LYNCH: Not at any price, no.

COMMISSIONER BLOCK: How do you make the decision? I mean, the Draft Guidelines make one pass at that. They use something which might be referred to as an optimal penalty here, trying to balance off the cost of monitoring with the cost of the criminal activity. But you say, well, no, I object to that, it doesn't lead to just punishment. But when I ask you what standards that you would apply, I don't see that I get a reply.

MR. LYNCH: Well, again, I prefaced my statement by saying I wasn't here pretending to be an expert on criminal sanctions. I was asked to give my views as a representative of the SEC because of our involvement in civil administrative proceedings and also our working with the Justice Department in criminal areas. But to deal with your question --

COMMISSIONER BLOCK: You felt free to say those punishments, those levels of fines, wouldn't lead to just punishments, so you must have some idea of what just punishment is in those cases, and you have yet to give it to me.

MR. LYNCH: Because, as I said at the outset, I think the concept and the economic underpinnings of the entire system are flawed. I don't believe that

organizations or individuals sit down and calculate the amount of money that they are going to make by virtue of engaging in illegal conduct, then have the economist within the organization map out what the likelihood is that they are going to get caught, and then come up with a result as to whether or not they should engage in that conduct or not. But as far as putting limits on the amount, one of the things that one could engage in, one of the exercises I think they could engage in -- and I am not certain it is practical to work into guidelines -- is the entire profitability of a particular organization within an organization. Dealing with the securities firms, for instance, with respect to the profitability of a trading desk where you can prove that the trading desk engaged in insider trading on several occasions, perhaps a corporate standard as to what the profits generated by that trading desk over a specific period of time were, rather than focusing on the two instances of illegality.

COMMISSIONER BLOCK: I guess, again, I get back to the issue that it is easy to wave your hand and say, well, this economic approach is too incomplete, it is wrong. If you will pardon me, I think that is a green herring, in the sense that without a name, I mean

take the name off, the attempt again is to try to provide a fine based upon some monetized value of the loss, multiplied times what is the likelihood that you will actually be called to task for this particular offense. It seems to me, taking away the names, that still provides some guidance which, when I ask for your notion of what the penalties should be, is lacking. Thank you.

CHAIRMAN WILKINS: Ms. Corrothers?

COMMISSIONER CORROTHERS: Mr. Lynch, you seem to share my concern that to reduce criminal sanctions by the amounts recovered in civil proceedings may not provide the organizations with sufficient incentive to discontinue criminal activity. My question deals with the topic that you did not cover, and that is probation. You indicate that the sanctions should ensure that the law violator does not enjoy the fruits of the illegal behavior, but that, beyond recovery of the loss, we must work to ensure that crimes do not recur. In that context, do you think that probation as a supplement to the monetary sanction will provide benefits as a preventive mechanism assisting in ensuring that crimes do not in fact recur?

MR. LYNCH: The question I would have with

that is, what happens when the corporation violates the probation? Aren't you back to the same situation that you were at before, where you have to come up with a sanction for the violation of probation? Again, it seems to me that you are back to the payment of moneys. It is really in most cases the only effective criminal penalty that can be assessed against a corporation.

COMMISSIONER CORROTHERS: Is there not a benefit from the monitoring of the firm's behavior to the extent that the organization complies with the terms of probation and they desist from the particular behavior? Is there not a benefit in that respect?

MR. LYNCH: I think there is a benefit. One of the features of enforcement action, as I think the SEC has pioneered, is building into settlements of SEC actions remedial steps that would be taken by the organization or corporation to make certain that the activity, the illegal activity, does not recur. I don't see any reason why many of those same concepts couldn't be transplanted to criminal prosecutions. But, again, in the criminal area, if the corporation doesn't fully implement whatever steps were ordered, you are back to the situation where the court is going to have to order a sanction, and again the sanction would be payments of

moneys, I would think, in more cases than not.

CHAIRMAN WILKINS: Any questions to my left?

COMMISSIONER BREYER: You say that you yourself are not involved in criminal violations but you say you have worked very closely and cooperatively with the Department of Justice and various U.S. Attorneys' offices on criminal prosecutions which they have initiated and your role in this process has helped shape your view.

In your experience, in how many instances, roughly, were corporations defendants in those criminal cases?

MR. LYNCH: Corporations are very infrequently defendants.

COMMISSIONER BREYER: How many, in your experience?

MR. LYNCH: Excuse me?

COMMISSIONER BREYER: You say you have worked very closely with the U.S. Attorneys and the Justice Department. In your experience, how many of the cases that you were involved in involved corporate defendants as opposed to individuals?

MR. LYNCH: No more than several, I would say.

COMMISSIONER BREYER: How many, would you guess? Can you name one?

MR. LYNCH: Three or four.

COMMISSIONER BREYER: Which ones?

MR. LYNCH: Three or four, I would say.

COMMISSIONER BREYER: Which are the names of the three or four or one or two, because I want to use a particular instance?

MR. LYNCH: Well, there is a case right now --

COMMISSIONER BREYER: Is there one that is over?

MR. LYNCH: Well, the case is a public case, Best.

COMMISSIONER BREYER: Three or four over how many years, would you say?

MR. LYNCH: Over, say, the last five years. By the way, I would like to be able to provide specific numbers for you, accurate numbers. That is just off the top of my head.

COMMISSIONER BREYER: Why don't you do that? That would be helpful, because if you say you are talking about one case per year, that roughly fits in with the ABA statistics and what we have gathered, too.

I expect it would be about one case, maybe sometimes no cases.

What I am actually driving at is that if we are talking about one case per year and half a case per year, which would be one every two years, what is it that led you to decide, or the U.S. Attorney to decide, to prosecute that one corporation criminally rather than to rely upon the SEC? Because you actually have, legally speaking, greater power to levy a fine than do the courts, because the criminal statute restricts the fine to twice the amount of loss while you can get three times the amount of loss. So I am quite curious and I think it would be helpful if I could find out from you what is it about that one case per year or one every two years that leads you to prosecute criminally rather than rely upon your normal SEC proceedings?

MR. LYNCH: We don't have the authority to get any civil penalties at all other than insider trading cases. That is the only area.

I mentioned a number of factors, and there are factors spelled out in the written statement that I think have to be considered: whether or not the corporation or organization profited from the wrongdoing; whether or not the conduct is something that

was known to the senior management of the corporation or could have been known through the exercise of --

COMMISSIONER BREYER: Can you give me an example? In an insider trading case, what are the SEC's powers?

MR. LYNCH: In an insider trading case, the SEC's powers are to get up to three times the amount of profit made as a penalty. Generally, we could get disgorgement and up to three times the amount.

COMMISSIONER BREYER: Through your civil powers, you can get up to four times the amount of the profit made, which is likely to be roughly the loss, maybe not quite. That is your normal civil case. I wish you would, if you can, through example, explain why you decide once every year or two to proceed against a corporation criminally? What was it you hoped to gain? If you can use a closed case as an example, I think it would be illuminating. What is it you hope to gain by making that decision to go criminally? I don't think it could have been getting more money from the corporation because you have more power to get money from the corporation civilly. Certainly that was true in the past. I mean, today the fines are limited by twice the amount of loss. They used to be far more limited than

that. I am giving you a little time because I want you to think it through, but what is it you hope to gain in that particular case by bringing it criminally?

MR. LYNCH: It doesn't help to give me time to think it through because as far as I know there has never been a corporation or an organization that has been criminally prosecuted for insider trading. So there is no instance that I can point in the insider trading area that would be helpful.

COMMISSIONER BREYER: What were they prosecuted for, the corporate case?

MR. LYNCH: Most of the corporate cases have been cooking the books, cooking the books where companies have sold securities with false misleading financial statements, which probably leads me to one of the most important factors: Did the entity itself profit as a result of the illegal conduct, or was it a case where it was someone out on his own, an agent of the corporation, that was out engaging in conduct primarily for their own profit and not for the benefit of the corporation? Or was it really conduct --

COMMISSIONER BREYER: It is fraud. It is fraud that you are after, but not fraud through insider trading. It is more like a sort of a con scheme?

MR. LYNCH: Well, it could be through insider trading. There have been no cases to date, but it could be.

COMMISSIONER BREYER: I am trying to think of why you went after these people criminally, and I think now I am getting an idea that you went after them criminally because it was like ordinary fraud cases, cooking the books, etc. OK, I have that. Could you have gotten your civil penalties at four times the loss there under the statute?

MR. LYNCH: No.

COMMISSIONER BREYER: All right. Then there is no argument. Basically you came in saying that ours were too low because you didn't like the deduction of the civil from the criminal. But now it turns out that the only ones you prosecute criminally are instances where you don't have that civil penalty. Now you are in agreement as to what the object is: to put the deterrence on. Is that right? So I don't think there is really a disagreement between you and Commissioner Block?

MR. LYNCH: The Insider Trading Sanctions Act came into being in 1984, and to date there have been no prosecutions of organizations under that. But I don't

think we should assume that there won't be prosecutions in the future.

COMMISSIONER MacKINNON: What was the Los Angeles case involving some corporation named Equity a few years ago?

MR. LYNCH: Equity Funding.

COMMISSIONER MacKINNON: Equity Funding.

MR. LYNCH: I am afraid that goes back before my time.

COMMISSIONER MacKINNON: Were they prosecuted criminally?

MR. LYNCH: I don't know the answer to that question.

COMMISSIONER MacKINNON: Wouldn't you agree that the civil remedies can be more effective than the criminal penalties?

MR. LYNCH: Oh, they can.

COMMISSIONER MacKINNON: More effective for deterrence?

MR. LYNCH: Particularly if you were dealing with a regulated entity, such as a brokerage firm or an investment banking firm. I am certain that they would rather plead guilty to convictions rather than be charged with an SEC action where the remedy would be

revocation of the broker-dealer registration. There is no question that in some respects the criminal prosecution of an organization engaged in the securities business could be a lesser evil for the corporation or firm than an SEC action where the ultimate relief were ordered in the SEC action.

COMMISSIONER MacKINNON: Thank you.

CHAIRMAN WILKINS: Again, thank you very much, Mr. Lynch. We will receive any written submission. We will make them part of the record.

MR. LYNCH: As I understand it, the only thing that is necessary is that Judge Breyer would like additional information on corporations or business organizations that were charged with criminal violations of the securities laws over the last five years.

COMMISSIONER BREYER: Yes, that would be helpful.

CHAIRMAN WILKINS: We will include your submission as part of the record when received. Again, thank you very much for your assistance.

(Witness excused)

CHAIRMAN WILKINS: The next witness is Mr. Cass. Mr. Cass is a Commissioner with the International Trade Commission.

R O N A L D C A S S, called as a witness, stated as follows:

CHAIRMAN WILKINS: Commissioner Cass, thank you very much for coming, and we appreciate your assistance.

MR. RONALD CASS: I am delighted to be here, Mr. Chairman and Commissioners. You have my testimony, although belatedly. With your indulgence, rather than read it, I will simply make a series of random remarks, beginning with the famous category of caveats and confessions. As required, I should start off with a disclaimer that I am not speaking officially on behalf of the International Trade Commission or any other commissioners, and after I respond to questions, I may conclude that I am not speaking on my own behalf either. (Laughter)

I also should indicate why it is that I am here, since you may be wondering why someone from the U.S. International Trade Commission would want to talk to you about sentencing of corporations.

I was looking at the sanctions that were proposed here from the vantage point of trying to decide whether there was some complication for international

competitiveness, whether the sort of sanctioning system that was being proposed would systematically advantage or disadvantage American corporations in international trade. It turns out that that is a very complicated thing to evaluate and there is not much I can say on that score.

However, having read through the guidelines, rather than simply tell you that I have nothing to say, I figured that I could invoke my prior existence as a professor of criminal law and relate to you some of my reactions to the discussion draft and to the other proposal before the Commission.

Now, in this regard, it strikes me very much like those views that academics have no doubt been party to when addressing either changes in the curriculum or changes in the grading system (laughter): There are two conversations that are going on and they are going on simultaneously, crossing one another, but they really ought to be separated out one from the other.

The first conversation is the conversation about normative ends or goals. What is it that you are trying to do with this set of sanctions, guidelines, or recommendations? The two proposals that have been put

before the Commission offer somewhat different normative standards. One, which is contained in the discussion draft of the staff, explicitly posits that you are looking for something that could be called optimal punishment or optimal deterrence or anything else that has the word "optimal" in it. The key thought there is that you want to prevent a certain amount of crime from occurring, but you want to do so not at any price but only at a time that equates social gains and losses. After all, what you are dealing with here is business enterprises that are engaged in discharging too many effluents into the environment or too many parts per billion into ambient air of pollutants.

I understand you exempted antitrust from your scrutiny for purposes of this particular discussion, but that is indeed the largest number of cases that involve corporate defendants. They have engaged in business activities which are a little bit too collegial with their brother companies or a little bit too sharp in their dealings with the public.

These are not, contrary to someone's suggestions that have been made this morning, activities that people sit around and have a debate on, will we violate the law, will we not violate the law. People

are busy conducting their businesses. The question is, can you get them in the conduct of their business to avoid practices that cross the line into illegality, and if so, how do you do it and at what cost?

Statements proposed by three law professors that the sanctions proposed in the staff discussion draft will still not deter some types of criminal violation are quite right and also, I think, quite beside the point. Of course they won't deter all criminal violations. No set of sanctions that any people who are rational about what we want our criminal law to do and agree on will deter all instances of crime. The real argument and the very hard argument for the Commission is, what set of sanctions equates the different social concerns on both sides of the balance? How ought you to go about trying to get business enterprises to internalize the cost to society of activities of theirs that are criminal?

That brings me to the second set of arguments. The second set of arguments are means arguments and that is the heart of the problem before you. If you want optimally to deter crime from occurring, how should you go about that? In particular, how should you go about that when you are dealing with

business enterprises, in particular business enterprises that for the vast majority of cases that will come -- I recognize it is a very small number that you deal with here -- but the vast majority of those are not big New York Stock Exchange companies, they are small closely held business enterprises?

Now, the argument that is made in the discussion draft is that business enterprises are mainly motivated by money, we are dealing with profit-seeking enterprises, and what we ought to do is try to figure out what sort of harm follows from illegal activity and try to get those enterprises to take that into account. What is proposed in the draft as the best way to do that is to try roughly to quantify losses and then, when you think you have captured the entire universe of people who are engaging in this activity, to use some sort of multiplier, as we have done in the antitrust laws with the federal damage remedies.

The complaints about this tend to come from opposite directions. One is a complaint that this doesn't deter enough. The other is that this will in some cases overdeter. Certainly there will be instances where both complaints are true. But I think that, by and large, what the discussion draft is trying to do is

to get a rough approximation of the correct level.

The use of probation has been proposed by three law professors as something that would be better or, at least as an adjunct, would be a useful addition to monetary penalties. The principal basis for that claim is that corporations and business enterprises are inefficient, that they don't always send the right signals to people at the top, and that unless you have some sort of regulation of their structure and their operations, you will not adequately deter crime.

I think it is quite clear that anyone who wants to make a case that businesses operate with imperfect efficiency has a fairly easy task. I would not mind doing that for a living. Certainly, businesses don't operate with anything approaching perfect efficiency, and I especially would not expect that of small, closely held companies. At the same time I doubt that anyone the court could find to monitor and supervise these companies would have a systematically better idea of what sort of structure and what sort of operations are best for those individual companies.

The point is made in the proposal from the professors that things like audit committees and independent boards of directors are well accepted by the

New York Stock Exchange as being good things for companies to have in place. I think that gets the problem a little bit wrong. Certainly, when you have a label such as "listed on the New York Stock Exchange" or "Certified by Underwriters Laboratory" or any other sort of label that you might want to apply to a company, there are standards that have to be uniform across all the enterprises that bear that label, and there is a great temptation on the part of anyone who can appropriate the label to do so without conforming to the standards. That is why, when you buy wine from Bordeaux, there is a little group over in France that tries to make certain that everyone conforms to the same standard in producing the wine; why the New York Stock Exchange is particularly persistent in policing certain types of business practices. There is no reason to believe, however, that for the general run-of-business enterprises there is the same sort of ability to free ride or appear to have certain types of business structures or any reason to believe that they will systematically diverge from the ideal in the sort of structures that they employ. Moreover, when you are trying to identify appropriate business structures for closely held corporations, there are enormous costs to

doing that. These are enterprises where the personalities that form the corporation and that run it differ mightily corporation to corporation, and where the interpersonal relations are quite difficult to discuss in the abstract and to organize. The reason why you have so many different forms of internal structure in closely held corporations is because people have very different skills, attitudes, and incentives for their behavior in these environments.

I think that the use of monetary sanctions is preferable when dealing with such enterprises and the sorts of criminal activity that are, by and large, found by the staff who have been engaged in the small number of cases that actually have been brought.

Let me just, before closing, address a couple of points that have been raised this morning by other witnesses. One is whether you ought to be guided in this endeavor by theory as opposed to practice or the real world. I will, for Commissioner Gainer, note that I am a lawyer, not an economist, by training and practice. At the same time I think that there is no doubt that whatever you do has to be informed by both some sort of theoretical construct and whatever sort of practical information you have to bring to bear. After

all, you are trying to organize somewhat unruly facts into a coherent set of guidelines to the various judges who will be applying them. Certainly, some type of theoretical overview is going to inform every member of the Commission, whether that overview is made explicit or not.

In addition, the question has been raised about whether money sanctions are a good idea to apply to corporations, because, after all, the money sanction will simply be passed through to consumers. I think there are two problems with that view.

One is that the money sanction won't be entirely passed through to consumers. Under only the most heroic assumptions about the demand for product and the array of suppliers of the product will you get that result.

Secondly, it seems to me that the questions about what you do if someone doesn't behave well on probation, how you police the conduct of the corporation when that corporation is on probation, and indeed, more importantly, I believe, before and after the corporation is on probation, all of these push you toward having some form of monetary sanction as the only way of really getting the corporation's attention.

Now, we can all disagree about exactly what the right level of sanction is, that is to be expected, the same way I disagree about the exact appropriate method for grading students. But the efforts ought to be the attempt roughly to figure out what the social cost of criminal activity is and to peg the sanction to that cost.

With that, let me bare myself to questions, with the explicit understanding that I don't expect to be of any help to this panel in my answers to those. (Laughter)

CHAIRMAN WILKINS: Thank you very much for your presentation and attendance today, and your thoughtful submission to us.

Any questions to my right?

COMMISSIONER BLOCK: Let me follow up where you introduced yourself as having had a past history as a professor of criminal law.

MR. CASS: Yes. I would not say criminal law professor. (Laughter)

COMMISSIONER BLOCK: I think a concern of a number of us on the Commission is: What is the basis for actually using criminal law against corporate entities, especially the larger corporate entities?

MR. CASS: I think that the statement was made earlier that you don't always have an identifiable individual against whom you feel you have sufficient evidence to move in a criminal context, but you believe you have a violation of social norms and duties that ought to be in some way prosecuted. Particularly if you look at the sort of activities that are prosecuted criminally, they tend to fit this pattern; and particularly if you have activity that broadly imposes small losses on a wide array of individuals, it is hard to expect them to be policed through ordinary lawsuit by these private individuals. Whether you call that civil or criminal enforcement by the government, some form of enforcement against the enterprise is likely to be the only practical means of getting that enterprise to take account of the social cost of its activity.

COMMISSIONER MacKINNON: I think what he wanted to know was why the corporation was liable. What conduct was it by the individual which necessarily had to be by an individual that made the corporation liable?

MR. CASS: Well, I hope that I understand the question correctly. I believe that any conduct that is taken on behalf of the corporation by people working for it can make the corporation liable if that conduct is

not better policed otherwise.

COMMISSIONER MacKINNON: I don't buy that.

COMMISSIONER BLOCK: Let me for a moment translate for myself and go back to that answer, and that is: What do you see as the difference between the use of criminal sanctions and the use of civil sanctions, say, administratively applied?

MR. CASS: That is one that we spend a fair amount of time on in a criminal law class and I have never been able to answer satisfactorily for myself or for students. I think that there is a difference generally perceived in the seriousness of the offense, but I don't think that there is any bright line that separates civil from criminal liability, and all these attempts to draw a line are, at least to my mind unsatisfactory.

COMMISSIONER BLOCK: So that, if I carry that through, then the deductibility notion, this idea of offsets, would be essential in getting the penalty right?

MR. CASS: I think the notion of offsets is essential to getting the penalty right. What you have to have some at least estimate of when you take the offset is whether the money against which the offset is

being taken is set probably at the right level, or whether you suspect that there is a systematic distortion in the way you are setting it, in which case you ought to rethink how you are setting it.

COMMISSIONER BLOCK: Thank you.

CHAIRMAN WILKINS: Any other questions?

COMMISSIONER GAINER: Since you raise the matter, Mr. Cass, let me acknowledge that I never had any question but that you were a lawyer, having come across in your paper first an ex ante and then an ex post and then a ceteris paribus.

MR. CASS: Thank you.

COMMISSIONER BREYER: Yes, I think you have particularly in the record focused on the problems of the close corporation. That, I take it, is basically what we are dealing with?

MR. CASS: It looks to me from what I have seen in the staff report that you are basically dealing with close corporations.

CHAIRMAN WILKINS: Thank you again.

MR. CASS: Thank you.

(Witness excused)

CHAIRMAN WILKINS: Our next witness is Professor Harry First. Professor First teaches at New York University School of Law.

H A R R Y F I R S T, called as a witness, stated as follows:

CHAIRMAN WILKINS: Professor, we are131 delighted to have you with us.

I might add, too, that Professor First has submitted his written testimony to us, and we will copy it, Xerox it, and distribute it, and also make it part of the official record.

MR. HARRY FIRST: Thank you, Mr. Chairman. I apologize for relying on technology that fails every once in a while, as our photocopiers at school. I also know as a teacher that talking to a hungry crowd is often difficult.

I was originally told by Paul Martin that I would have five minutes, and I figured that, as a law teacher, any law teacher worth his or her salt could criticize anything for five minutes, which is what I

plan to do. Then I heard I had fifteen minutes and it struck me I had to come up with something other than criticism. That is a lot harder. And I am a little nervous about it, since you have given a lot of attention to fully working out this draft, and I just have sort of the outlines of a suggestion, but I have provided it in my statement.

I would like to just briefly summarize some of the things I said in my statement. I have the feeling, just listening to some of this conversation, that you may have heard some of these things before, so I will try to be somewhat brief about it.

I divided my prepared remarks into three parts, the first dealing with the two conceptual questions, and I heard some of the questioning dealing with that; second, some problems I have in terms of implementing the proposal that is under consideration; and third, some suggestions I have of my own which are somewhat different than the proposal you have come up with.

The two conceptual questions are basic and they have been talked about. The first: Why do we impose organizational criminal liability? The second, which I think has been talked about but perhaps not so

clearly: What is the model of organizational behavior with which you are dealing? If you are going to impose a sanction how do you think organizations operate so that you can be certain the sanction will be effectively carried out?

The Commission gives, in these Draft Guidelines, some very clear and consistent answers to both questions. I applaud the draft for that. I just happen to disagree with both answers. The two answers are, the reason is deterrence, and the model of the corporation is the corporation is a rational actor maximizing profits.

I just say briefly my own point of view is that our feeling that deterrence is the sole goal stems from an overemphasis on the way in which corporate criminal liability came into American law, and that was through analogy to tort liability. It seems to me that this does not give adequate weight to the usual and expectable reason for imposing criminal liability, which is a sanction for blameworthy behavior, some concept of just deserts.

As for the model of the corporation used, as this rational actor maximizing profit, I don't happen to agree with that, at least for all corporations, although

it may describe some of them fairly well. It seems to me corporations are not simply a production function mechanically combining inputs to produce outputs, and particularly as we get to larger corporations they are much more organizationally complex. So it seems to me that whatever sanctions are chosen ought to take account of that.

The second part of my remarks deals with some problems with the proposed guidelines, and specifically with the formula, which in a way, in the context in which it is set, assuming deterrence and the rational actor, makes perfect sense. However, I just don't think that it works. Again, I haven't heard everybody, but I can't believe that others haven't said the same thing that I am going to say, so I will try to say it quickly.

Determining the two major variables are obviously determining loss and the offense multiple. I think that the Draft Guidelines significantly underestimate the difficulties of determining loss. I think particularly unclear at this point is the extent to which those determinations will have impacts on the civil side and the extent to which they will have an overflow effect on civil litigation which may affect the ease or difficulty of making these decisions in the

context of a sentencing hearing. A third reason is the difficulty of measuring intangibles; for example, a foreign bribe, prosecuted under the Foreign Corrupt Practices Act. I am not certain how one would measure the cost of that behavior.

Finally, of course, the theory depends on identifying social cost. If it just identifies private cost, then you are off the mark. And it seems to me that that just stems from economic theory. Although there are parts of the guidelines which attempt to give some look at that, it is not done on a systematic basis and it is daunting. I don't know how one would do that.

With respect to the offense multiple that is chosen, the basic 2.0, 2.5, from what I saw of the study, which was printed with the guidelines, there is not adequate support for those multiples and the study itself cautions against those sorts of generalizations. Frankly, although I would be glad to hear this, I am not sure how you would figure out the multiple, because it must depend on the amount of crime undetected. I don't know how we know how much crime is undetected since we haven't detected it. But, beyond that, you go on to how much is not prosecuted criminally, since, as we have seen, there is a tremendous civil component, and

prosecutorial discretion often picks the civil penalty. Then how much that is finally prosecuted criminally is prosecuted successfully to a conviction. I think you are asking a question that is very difficult, frankly I think impossible, to answer.

The bottom line for me on those two parts -- and there are others which I have tried to explain in my testimony, you can of course try to estimate these and you can come up with some number, and whatever number you come up with will, of course, deter something or somebody -- is that the theory depends on choosing a pretty accurate number or else you will not have optimum deterrence or, as one might say, the optimum level of crime. And if, as I do believe, the guidelines systematically underestimate loss and overestimate the probability of successful conviction, within the conviction context of the theory, you will underdeter, which seems to me not to be the result that you would want to aim for.

I was trying to think of some colorful analogy in response to the statement that you will get some deterrence. The only thing I could think of was that it was like trying to get to the moon by driving your car uphill. You can go uphill and you would be a

little closer to the moon, but I don't think you are going to be anywheres as close to the moon as you are trying to get. I hope that that analogy works. But, in any event, to me it indicates that this conceptual framework, however pleasing it is as a matter of theory, which is debatable in itself, cannot translate to what the Commission is trying to do in these guidelines.

With regard to specific guidelines, I would also like to take the Commission's invitation to make some mention of the antitrust guideline which is currently in effect. It seems to me to be obvious that the guidelines' organizational sanctions in antitrust have to be handled within the same framework that one handles any other effects. I don't know how the Commission could just simply pretend it is in a different framework. You don't do that for any other sanction for individuals, and it seems to me you would have to bring it in.

Once you bring it within the framework that is currently proposed, then I think it is up to the Commission finally to justify the decisions that were made in that guideline, which within the context of these proposals are quite different. I will focus again on the estimate of loss and the offense multiple. In

the antitrust guideline the Commission did not say prove the loss, as it says for every other one. It says we will estimate, for example, for bid rigging, that the amount of loss is 10 percent of sales. And it also estimated a multiple of 2 to 5, which is significantly higher than for any other crime. So far as I can tell, there is no support, and the Commission so far as I can see gave no support, for either estimate.

Again, if the Commission is really trying to stay within this conceptual framework, rather than just come up with any number, which it could do much more easily than going through all of these steps, if it wants to stay within that framework, then I think there is some need to justify both of those numbers. So far as I can tell, they stem simply from unsubstantiated testimony by the former head of the antitrust division. As I said, I have never been able to find any empirical support for either.

So I am perfectly willing to take this opportunity to sound off on an older gripe, which is the antitrust guideline.

Briefly one other thing with regard to the guidelines and the model of organizational ability. I think that the guidelines do attempt in two areas to

take account of the fact that we have organizations, but I am not all that satisfied with how it is done. One is the notion of employee fines, which are deducted from the corporate penalty, consistent again with the economics-only theory, which the guidelines use. It seems to me if one does take a view, which I think that many organizational theorists take, that larger corporations in particular are not simply those members who happen to come forward at a particular time, I think one would focus still, and not deduct for, but focus still on putting the full penalty on the organization.

I would suggest changing that for more closely held corporations, where the principal is one of the defendants and is fined. I think in that case you do have a different sort of organization. The principal could be fined by percentage of equity ownership 10 percent, for example, as used in the Securities Acts, and at that point I would recommend deducting the principal's fine from the corporate penalty on the theory that this might be in fact a double penalty, in a very different organizational setting.

Finally, something that I will leave to others to work out more fully, since they did, particularly Professor Coffee, people who will be

testifying later, I think the Commission has taken much too narrow a view of the uses of corporate probation, however one might want to structure it. This, it seems to me, gives the Commission an opportunity to actually do something with the criminal sanction, do something beyond simply fines, whose deterrence effects are unclear, but to try to look for conditions which would rehabilitate the corporation, if you want to think of it that way, and help to make sure that the behavior is not repeated.

So I would echo their call for probation, subject perhaps to a minimization requirement, as we have in other areas of criminal law, and then I am going to let them defend the particulars of their proposal, since it is much better worked out than I have had a chance to do.

Briefly, the alternative I worked out a little bit in my remarks is that sentencing should be based on the size of the offender, that fines should be based on the size of the offender, and I suggested that for several reasons.

One is that it is easier to determine, rather than the amount of loss.

Second is the old exercise motto: No pain,

no gain. It seems to me that fines do not pinch equally sized corporations equally.

The third is the deserts aspect, and it seems to me that there is a feeling, and it is referred to in the Sentencing Reform Act, that larger corporations deserve larger penalties even for the same acts.

The proposal that I have given you, although thanks to photocopying you don't have it, so maybe you won't be able to tear me apart so closely, tries to take advantage not only of organizational size but the degree of economic harm, plus the amount of corporate responsibility that is involved, the extent to which management is involved or the corporation was lax in its procedures for ensuring compliance with the law.

I have gone more than my five minutes that I thought I would have to and maybe a little less than the fifteen. I appreciate your sitting here and listening. I would be delighted to try to respond to any questions.

CHAIRMAN WILKINS: We appreciate your participation. Any questions to my right?

COMMISSIONER BLOCK: I had a question on your basic problem with an interim approach, recognizing that any proposal that would come up with it will undoubtedly just be starting ones. Is your objection to an interim

approach to this, where one tries to get at the loss and then some multiple and tries to move toward a better system, is your objection to that your skepticism that firms really don't maximize profits and that any attempt to sanction firms using monetary incentives is bound to fail, or is it a concern about the objectives of the punishment system?

MR. FIRST: No. Yes. I was hoping I would have a third. I don't think that fines are bound to fail in the sense that one would say that no corporation would pay any attention to a fine. In fact, my proposal, I think, takes a different approach and says that fines can have some deterrent impact. So I don't view it that fines can't deter. I think, within the context of the goals set, you will never get to that optimal level of deterrence. So it seems to me if you are thinking about fines for deterrence, it might be useful to come at it from a different conceptual framework, because this one I don't think is going to get you there.

You look puzzled.

COMMISSIONER BLOCK: Yes, I am puzzled. Perfection is not possible. I know that you have something deeper than that in mind, that in fact we

won't get it perfect so we shouldn't try. I know that you have something more sophisticated than that in mind.

MR. FIRST: I appreciate your feeling about that. It is part of that, that the goal you are setting, which is a very complicated attempt to reach that goal, is not going to work, which I think counsels the Commission to think of deterrence not in perhaps the same way or with that sort of rigor. But, of course, you are right, I don't think that deterrence is the ultimate goal; and at times pursuing a deterrence-only policy, even if you could work it out, even if you could do this correctly, I don't think would satisfy the reasons for having corporate criminal liability. I don't think that it would necessarily provide some concept -- and I can't get the exact amount either -- but some concept of just deserts.

The example that I mentioned earlier seems to me to be one to think about, which is the prosecution under the Foreign Corrupt Practices Act for bribing a foreign official. There may be social benefits in the U.S. economy to that, but Congress has said it is a crime.

COMMISSIONER BLOCK: Let's go to these large organizations. Take the large publicly traded

corporations. I think we have to address that issue. What is the punishment or deserts issue involved in these large publicly held firms where much of the stock is held by pension funds and there is very diffuse ownership? I guess I fail to see the punishment.

MR. FIRST: I think the imposition of a nontrivial fine does say something to people's perceptions about how seriously or not seriously we take an offense, and we take it with regard to a particular corporation. I don't think it is as quantifiable perhaps as one might like, but then it turns out that true economic deterrence is not readily quantifiable either.

COMMISSIONER BLOCK: But you are not suggesting sentencing is theater, are you?

MR. FIRST: That sounds very good. I am suggesting that there is a notion in any criminal sentence that taps on the wrist mean one thing, something other than that means something else. Congress says particular behavior is a crime, that there is some notion that blameworthy behavior has occurred and a criminal sanction should be imposed.

COMMISSIONER BLOCK: And that is different than the incentive to provide to the firm to watch its

agents?

MR. FIRST: I think that is different. I don't have some notion that we can only pursue one policy in sanctions. I don't think the criminal law has ever had that policy.

COMMISSIONER BLOCK: I am just trying to understand with a large publicly held firm. It is easy to say that, but I am still asking for some translation. Are you punishing the stockholders?

MR. FIRST: You are asking in part an empirical question, is there any punishment on the stockholders? Perhaps there is. Is that the purpose of it? No. I think the purpose is to show some seriousness of punishment of the corporation as an organization, which is how we have always viewed it.

COMMISSIONER BLOCK: I guess I find this discussion frustrating, because I see this large corporation owned by stockholders, and you say we need punishment qua punishment. I say, what does that mean? You say, well, it is not to punish the stockholder. Then who is it to punish?

MR. FIRST: We do not criminally indict and prosecute the stockholders, even though the argument was made in 1909 in the New York Central case that this

would punish innocent shareholders. We view it differently. I don't have a lot of trouble viewing the corporation apart from its shareholders, and I don't think as a factual matter that is a very difficult thing to do. There are a lot of constituencies that may be hurt by hurting a corporation, and fining a corporation and the shareholders are only one of them.

CHAIRMAN WILKINS: Any questions to my left?

COMMISSIONER BREYER: I agree with your point that these are too refined and they should be made simpler, etc. That is your basic point of criticism?

MR. FIRST: In terms of implementation.

COMMISSIONER BREYER: Yes. I don't understand -- I will ask him later -- how you find the unfound crimes. I always assumed it is how the economists make estimates of how much oil remains to be found. (Laughter)

MR. FIRST: Then it must depend on the price that one would pay for crimes, because we get more oil as the price goes up.

COMMISSIONER BREYER: The way they do it is that they estimate all the oil in the earth and they subtract the oil already found.

MR. FIRST: OK.

COMMISSIONER BREYER: Skip that. I don't understand your criticism of the antitrust part, which I would be interested in, because we have some pretty hefty fines there. It came out of the Attorney General's impressionistic testimony. And some information is better than no information. I think what we had was that they said there are some estimates that about 10 percent of the price is usually attributable to price-fixing. Of course it is extraordinarily rough, but people didn't seem to have a better estimate, and then they said about 2 to 5 times reflected difficulty.

MR. FIRST: I guess I have a feeling that if you pick a conceptual framework, as you say you are going to work with, then these numbers are not just rough estimates, they are guesses, pure guesses.

COMMISSIONER BREYER: Yes, pure guesses.

MR. FIRST: The 10 percent that was testified to in the testimony on which I think the witness relied and on which Doug Ginsburg testified, it was 10 percent sales, at best a 1 in 10 chance to be prosecuted, which, strangely enough, meant the fine would be a full amount of 6.

COMMISSIONER BREYER: So we should double it?

MR. FIRST: No, no. I am saying the numbers

themselves I think were designed to produce a result, if that is the result that is wanted.

COMMISSIONER BREYER: You don't have better numbers.

MR. FIRST: I don't think anybody has numbers.

COMMISSIONER BREYER: All right, fine.

MR. FIRST: And I think if the Commission says we want major fines because we think they will deter more than minor fines, that is probably right.

COMMISSIONER BREYER: I have written down the reasons, as people have been giving them, as to why we prosecute corporations criminally at all: can't identify the responsible individuals; you have another one, we might want to get some money out of them for restitution; we want the corporation perhaps to install control devices; and maybe sometimes, when it is a small, close corporation, it is the instrumentality of the crime. Do you have anything other than those?

MR. FIRST: I think that what I would add to that is that there are circumstances in which we feel the corporation is to blame, has engaged in blameworthy behavior, organizational behavior which is complex.

COMMISSIONER BREYER: All right, the just

deserts. I have that in mind. I understand that. The more I learn about that theory, the less enamored of it I am.

MR. FIRST: Then we should say no more.

COMMISSIONER BREYER: Another question: Why would you say a large corporation should be punished more than a small one? You would normally think it was the other way around; that is to say, I have always thought it is like small investors versus large investors. The stockholders used to say we want to help the small investor. But the large investor turned out to be a pension fund for all the laborers, workers and ordinary people, and the small investor is some independently wealthy person like Rockefeller or somebody. Why wouldn't that be equally true of corporations? The small corporation which is closely held is likely to be the property of a rich individual, while the large corporation is in fact the recipient of pension fund money, of unions, of widows, of orphans, and therefore, insofar as you are punishing the large corporation shareholders, you are getting at people to whom additional money means a lot, while insofar as you are punishing the small corporation shareholder, you are likely to be punishing a richer individual to whom money

means less. Therefore, insofar as there is some marginal disutility to money, you would think it would cut just the opposite way of what you are suggesting.

MR. FIRST: I have two responses to that. One is that I think that the impact on shareholders of a fine on a very large corporation is very diffuse. So I am not certain how much hurt is directly translated down to shareholders.

COMMISSIONER BREYER: What reason is there for punishing a larger corporation for doing an identical thing more?

MR. FIRST: OK. The second part would be, I think, going to some notion of deterrence, some sense that an equal-sized fine will not produce the same amount of deterrence.

COMMISSIONER BREYER: Is there any information suggesting that?

MR. FIRST: No more than saying that an equal- sized fine will.

CHAIRMAN WILKINS: Any other questions?

Thank you very much, Professor.

MR. FIRST: Thank you very much.

CHAIRMAN WILKINS: We may reserve the right to come back to you again to further pursue these

issues.

COMMISSIONER BREYER: I am sorry it was so quick.

MR. FIRST: Oh, no, no. I have a 2 o'clock class, so I appreciate it. Thank you.

CHAIRMAN WILKINS: We are going to take a break now, and we are going to come back promptly at 1:45, because we have witnesses scheduled this afternoon, some on tight schedules. That will give us about a 45-minute break. We will start then at 1:45.

(Luncheon recess)

AFTERNOON SESSION

CHAIRMAN WILKINS: Our next distinguished witness is already seated.

J O H N C. C O F F E E, JR., called as a witness, stated as follows:

CHAIRMAN WILKINS: Our next witness, Professor John C. Coffee, Jr., teaches at Columbia University School of Law. In addition to the testimony submitted, Professor Coffee has a submission that has been placed in front of the Commissioners here in attendance.

We are ready to proceed with this afternoon's session. We are delighted to have you with us, Professor Coffee.

MR. JOHN C. COFFEE, JR.: Thank you. It is a pleasure to be here. You have heard a lot of words, so I think I am going to use a very simple, basic outline in my comments. I have four basic points to make, which are set forth in those memoranda. All address the discussion draft's proposals on fines. I will not take your time to argue further the case for probation

guidelines or the guidelines that my own committee drafted, except in response to any questions that you may have.

In overview, my basic message is that the discussion draft is an object lesson in how even a powerful model is vulnerable to the GIGO effect. The GIGO effect, familiar to all social scientists, says garbage in, garbage out. No model can outperform the available data. In this area of criminal justice I am afraid we do not now have the data, or are likely to obtain it in the future, that is sufficiently reliable to make the proposed system operational.

Even if that data were available, I do have some philosophical problems with the particular approach in the way it treats the offense loss and looking at the equivocal social loss. But I don't think we should focus on those principles. I think the major problems are the operational ones that you need to focus on in the short term.

Putting my criticisms under four headings which move from the specific to the general, let me take them one at a time in overview, and then come back and talk a little about case law and alternatives.

The first point. I think that the discussion

draft would impose an unacceptable procedural and logistical burden on the prosecution and probation staff, because no more than a trivial fine could ever be imposed without the prosecution and the probation staff proving the damages, the social loss caused by the crime, at a sentencing hearing. As a result, the tail begins to wag the dog. We have the sentencing process becoming more elongated, more complicated, and this is a matter that constitutional case law has begun to complicate in the last few years. This is not a matter where you can easily change the procedural basis for determining those sentencing facts off which the guidelines would operate. The net result, although unintended I am sure, is to create a serious disincentive to prosecute organizations. Prosecutors have other things to do with their scarce time besides prosecuting an organization if the aftermath is to produce an extended hearing or quasi-trial over the damages caused by the crime. That is a totally new burden imposed on an already overworked prosecution enforcement establishment.

The second point. This is all just a quick cook's tour. The concept of offense loss, as embodied in these guidelines, I believe undercounts the true

social loss from many crimes. In particular, it tends to trivialize the loss in what I will term public integrity offenses, such as bribery or obstruction of justice. That is where federal prosecutors today concentrate their efforts. That is where their own priorities are. But it is exactly those kinds of crimes that I think tend to be trivialized by focusing solely on the property loss. These guidelines make it very clear that you focus on the property loss, and then in general you disregard factors such as kickbacks of bribes, breaches of fiduciary duty, except to the extent that they have some impact on the offense multiple. They don't count as part of the loss. I think that is inconsistent with the normative sense that most of this country has.

Think back to the most important prosecution in terms of our political history over the last two decades: Watergate. There was no property loss in Watergate. Watergate involved public integrity issues. So do a number of other recent prosecutions, whether of governors or Senators. The property loss is a trivial aspect. The real loss is that a public official has been corrupted. And we know what the truth is, that a public official once corrupted tends to remain corrupted

and there is a continual loss, a ripple effect, that extends beyond the particular financial gain or loss between the two parties involved in the particular transaction.

I am going to try to illustrate my contention that the property-loss approach undercounts the true social loss for many crimes by walking you through several recent corporate prosecutions: the Hertz case, E.F. Hutton, Allied Chemical, the Current Defense Procurement scandals in Washington, and possibly a future prosecution, if it occurs, of Drexel Burnham, just to show that the losses under these guidelines tend to understate the basic loss that society sees and that today motivates the prosecutor to bring this kind of case.

Again, the basic point here is that penalty levels will be reduced and deterrence will be decreased rather than increased if we have a narrow view of offense loss.

Let me say, parenthetically, nothing that I am saying here takes issue with the relevance of economics to criminal justice. It is my contention that nothing in economics tells us what the offense loss is or tells us what the offense multiplier is. Those are

problems of data. My contentions today are all at the level of what the data is that we are using to operationalize this system.

My third point involves the guidelines concept of an offense multiple. This is an understandable attempt, but I think it does rest on what is basically an imaginary foundation. I have had the experience, as have others, of spending three years on a National Academy of Science panel that tried to estimate what the likelihood of apprehension was in terms of sentencing guidelines. That panel was a successor to another panel that spent three years looking at deterrence and incapacitation. Other members are familiar with that experience. I think during that period no one felt there was even an ability to estimate crudely and roughly or in any ballpark sense what the likelihood of apprehension was in any crimes. We also understood that most crimes tend to aggregate. There is different behavior in different contexts within one crime category. But the attempt made here, and it is bald and it is candid, is to say that the appropriate offense multiple should normally be 2.0 or 2.5, possibly moving up as high as 3.5. That means in essence that we are saying that the risk of apprehension and conviction

for most of the crimes that these guidelines would govern is essentially 50 percent or 40 percent, working off of 2.0 and 2.5.

If anyone thinks that there is a 40 percent chance today, much less a 50 percent chance, of being apprehended and convicted for insider trading, I think I can cite them the data that shows otherwise, and I have cited some of those cases which have been done in a very detailed, concrete, specific way by people like Susan Shapiro on the aftermath of SEC civil complaints and civil prosecutions. They suggest their own data in the book Wayward Capitalists, which was done through the Yale Study of Criminal Justice, and found that all the SEC investigations brought by the SEC staff over a forty-year period -- forty years, large numbers -- out of all of those where they have detected the individual, only 4 percent went on to conviction. So in that particular context, 9 percent were acquitted. You have to subtract out the innocent, and that is a problem with the data, but only 4 percent seemed to result in any conviction. That is again based on a base of people who have been detected. We lose 96 percent between detection and conviction. That does suggest that 2.0 and 2.5 don't correspond with the real world, as others

who have investigated the specific context seen to see it.

Finally and most generally, in setting penalties we must balance two types of error. And errors are inevitable. One error is the danger that one class of offenders will be overdeterred by excessive penalties. I accept that as a valid concern. The other type of error is the danger that victims will be underprotected by inadequate penalties that do not deter.

Normatively, I submit, these two kinds of errors cannot be equally weighted. The victim deserves more concern than the offender, who after all has been convicted of breaking the law, where he had fair notice, he had fair notice in advance. To the extent that we are concerned about the offender being overdeterred, the offender does have recourse to the legislative process. It can lobby. The victim doesn't have that ability. The victim doesn't have the ability to seek political recourse. I think the country as a whole is much more concerned with the loss to victims than the potential overdeterrence of offenders. Yet, under a system that looks just to the total social cost, one dollar in excessive penalties is seen as seriously in error as one

dollar in serious injury to the victim. I do think that precision is not possible. We have to make the judgment to err on the side of protecting the victim rather than protecting the offender. And I think this draft tries to be neutral between those two. I don't think society as a whole is ready to accept neutrality between the victim and the offender.

Let me return to my basic points and start with the one that I think deserves the greatest emphasis in terms of its procedural and operational impact. This is the first point about the burden on prosecution by asking them to prove the social loss from the crime. The flaw here, as I see it, is that the staff's approach in the discussion draft combines very low minimum penalties, as low as $500 in terms of the base loss, with an attempt to compute the actual harm or loss. Such an approach might be defensible if it were as simple to compute the actual loss at sentencing, as the staff seems to believe it is. The staff's draft repeatedly asserts that its rules do not requie absolute precision, and are satisfied by reasonable estimates. Unfortunately, that discussion is not a serious attempt to consider any of the following problems: The information base available to the court at sentencing,

the problems inherent in acquiring reliable information at this stage of the criminal process, or, most of all, the major legal issue of the burden of proof.

You will see at page 8.9 that the staff says that 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. T

his is unfortunately a fast shuffle. It tends to confuse two different issues. It confuses the admissibility of information, where here I agree sentencing law is very relaxed and the rules of evidence do not apply, with the distinct issue of the burden that the government must satisfy before information may be relied upon for purposes of determining the sentencing guideline. On this latter point, recent developments have clearly changed the preexisting 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. I cite some of those cases, but the basic point is, whether the standard is preponderance or whether it is, as one or two courts said, clear and

convincing evidence, either way the prosecution has an enormous burden that it doesn't today have.

Take, for instance, the recent prosecution of Hertz for falsifying literally hundreds of insurance appraisals reports with respect to renters of its cars who suffered an accident, a well-known case in the Eastern District. If you ask the prosecution to prove that burden, it may not be a full-scale civil trial of damages but it is going to be a hearing at which prosecutors have to meet the preponderance of evidence standard, and that is a complex factual issue that is going to inundate the prosecutors.

Consider the vast number of persons injured by Allied Chemical's actions in dumping the toxic chemical kepone into the Chesapeake Bay. It is really impossible for the prosecution to be given that burden of proof without their being given an incredibly large and daunting level of new resources. Absent that, the prosecution will have a very strong disincentive from prosecuting organizations. It will focus on individuals to avoid the problem of having to have this quasi-civil damages trial. Worse yet, not only does the government have the burden at this stage but it must fight with its hands tied behind its back, because at present no

procedures exist by which it can obtain discovery at sentencing. I happen to have been practicing recently in this area. Following indictment, the Federal Rules say that the grand jury process is no longer available. Nor may the prosecution then subpoena evidence. That is Federal Rule 17(c) of the Federal Rules of Criminal Procedure. The court may subpoena witnesses to a sentencing hearing, but asking the Court to get significantly involved in this process, just again makes the tail longer and longer and more likely to be wagging the dog. We have a multitude of injured victims. We are not going to have the court in each one hear testimony in open court, but that is the only discovery procedure that currently exists.

In short, there is no mechanism for discovery largely because the traditional assumptions of the criminal process, now somewhat out of date, contemplated that the prosecution had gathered all its evidence by the time it brought the indictment. This is, I think, an out-of-date assumption, but still it is the real world. To ignore the fact that there is no mechanism for obtaining information at this stage is really to assume a can opener and disdain the realities of actual sentencing practice.

Those realities today are that the Probation Service is basically relied upon to prepare a victim impact statement. Victims, of course, may approach the Probation Service, which can then prepare that report. But without intending to criticize the Federal Probation Service, I must observe that probation officers are ill-equipped to perform the role of fact-gathering and damage assessment in a large case. Indeed, victims many themselves come forward at a fairly low rate.

The experience in class actions is illustrative. Even when you have a large settlement fund and the recovery is there on the table, typically only a small percentage of the plaintiffs covered by class action ever come forward in a federal securities class action to obtain their recovery. Apathy is a fact of life and that tends to produce here undercounting as a social loss if we just rely upon those victims who wish to come forward and assert their injury.

Finally, one simply can't ignore the motivations and incentives of prosecutors themselves. They have never really been interested in sentencing. Their life is lived elsewhere. The exciting moment for them is the excitement and glory of trial and conviction. If they have to add this new burden of

proving damages by a preponderance standard, gathering information at sentencing before there can be a meaningful sanction, their likely response is to focus elsewhere and focus only on individuals. Thus, if the discussion draft is correct, and I agree with them, that it is necessary to focus on the principal, the organization, in order to make it monitor its agents, their procedures are likely to frustrate their own goals and procedures.

What then makes sense? I would submit that the best solution here would be to try to combine a notion of multiple, a notion of a reasonable multiple of the gain or loss, with high minimum penalties, simply because that gives the prosecutor an option. The prosecutor can then know that merely by obtaining a conviction there would be a real sanction, a high minimum penalty. And what that level is I would rather leave to your judgment. I think it should depend on crime severity. I do not think it should depend on the size of the corporation. But you can consider those issues without my comment.

Then the role of the gain or loss would be to have a ceiling on the crime that would be a reasonable multiple of the gain or loss. That means we

would never have the prospect that either an overworked court or an overworked prosecutor would simply decide not to go after damage-loss computation and leave us to fall back on the default rule of 1,000 or 2,000 or 5,000 as the default rule for the loss, for the base loss. I think if you took that out and moved up to something, maybe a quarter million, maybe a half million, for the more serious crimes, and then said the court, where it is proven to it, could impose a higher fine equal to some reasonable multiple of the greater of the gain or loss, I think that would combine the best of both worlds, allowing the prosecution a mechanism that didn't have a great burden but also giving it the upside of proving the real damages in a significant case.

One point that I do want to emphasize -- and my time, I guess, is running short or has been exceeded already -- I want to focus on these guidelines as they define the social harm. As I mentioned earlier, they are keyed almost exclusively to property loss. Indeed, the guidelines explicitly state at page 8.13 that the 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. That is not the view of the criminal law that either the professional establishment in the field or the public at large has.

Note that the consequence of these guidelines would be to treat the following two cases alike: Case 1, Corporation X defrauds Corporation Y of $100,000 by selling substandard goods, which it misidentifies. That could be prosecuted as mail fraud, one corporation cheating another out of $100,000.

Now Case 2. Corporation X is in a lawsuit with Corporation Y, or with that same dispute, and it bribes a federal judge to win a verdict.

Those two are treated identically because the property loss here is the same amount, $100,000. The only way you could deviate would be if you found this changed the offense multiple a little bit.

I suspect that the country at large is quite aware that there is a different kind of loss that should be cognizable here, and that is the loss caused by the fact that a public official has been corrupted. That is indeed the paramount injury. It is the more lasting injury, because, again, officials once corrupted are going to continue to remain corrupted, and it is going to result in public cynicism and a lack of respect for

governmental institutions.

If you change nothing else, I suspect you should change the definition of offense loss so that you can recognize that much of the federal criminal law -- the Hobbs Act, the Travel Act, Obstruction of Justice -- is concerned with bribery, is concerned with corruption, and is concerned with how citizens view their government as honest or otherwise. Focusing only on the property loss moneys, which these guidelines are, is to wear sort of moral blinders.

I have several cases that I discuss in the materials. I don't think we have time to go through all of them, but just to take two. I take you through the defense procurement fraud that is now a major topic in Washington, although there have not yet been many indictments. If we were to assume that Corporation A bribes a senior official in the Defense Department to obtain contract specification data on a proposed weapon system, and that is fairly close to the stories that have been unfolding in the newspapers over the summer, what would be the impact under these guidelines? Let's assume that, as a result of this release of privileged information, Corporation A is able to submit a slightly lower bid. Notice that doesn't cause a property loss to

the government. The lower you submit the bid, the better off the government is. But let's walk it through guidelines and you will see, at page 8.13, Section 8B2.2, that we are told there that the loss in this case is the loss to the government of "the increased cost to procure the product." There is no increased cost to procure the product in the case I have given. Nor am I willing to assume that there is automatically any injury to the national defense. The prosecution will have to prove that, prove that by preponderance. It would be very hard to prove, where you are dealing with major producers, all of whom have produced a weapon system that the Defense Department was quite happy with. Nor is it possible to go back and correct the awarding of the contract, for this the prosecution will probably find they are three or four years into the system, into the development of this weapons prototype, and no one is able to go back and cancel the weapon and start over. National defense interests override. Given that, the base loss under 8B2.2 would be as low as $5,000 plus enforcement costs. I think that trivializes that kind of crime and it invites further fraud in defense procurement contracts.

I go through a similar example on insider

trading. I take the allegations that are essentially set forth in the SEC's complaint against Drexel Burnham. I don't mean to assume the truth or accuracy of those contentions. But if they were true, they essentially charge a stock parking violation. A stock parking violation occurs when someone fails to report that they have crossed a specified threshold, 5 percent, 10 percent, Williams Act or some other statute. Thus, the regulatory guideline applicable would be 8B2.7, at page 8.23, which is captioned "Regulatory Reporting Offenses." What happens underneath this? Assume that the defendant, Drexel or someone else, didn't file the required Williams Act 13D schedule when it crossed 5 percent but filed it fifteen days later when it crossed 20 percent. And you now have a corrected filing. This happens to be the real world, that filings deliberately come in late so you can accumulate stock in the interim.

Under these guidelines, you focus on the administrative cost that the SEC would incur in correcting the disclosure. Here the agency has incurred really no administrative costs because the offender has itself corrected the violation weeks or months later. Even if the SEC did incur some cost, it would be the cost of staff time, it would be a fairly small amount.

Absent any SEC administrative cost, the base loss would be as low as $500.

I think we are trivializing a regulatory reporting offense. We are telling Drexel Burnham or people like that in the future that if they do not file and if stock parking violations occur, at least in terms of the federal securities law, the base loss could be as low as

$500 times the offense multiplier and the enforcement cost. It is all very, very small and it takes the criminal law out of this picture.

The real injury, of course, here is not the injury to the regulatory agency but the injury to the market. Investors out in the market would otherwise have been given data that Congress meant to give them, data that would have told them that a corporate control fight is looming and the value of their shares is much higher than it was in the absence of that information.

I go through several other instances involving corporate homicide, environmental violations. I don't think it is useful to take your time further. I would make one comment about them. Throughout these guidelines there is never any distinction made between negligence and intentional misconduct, between

recklessness and knowing intentional misconduct. If anyone is taught from the law, as I usually teach criminal law, that tends to be the major question in the history of the criminal law: defining mens rea, defining the levels of intent. I think Justice Holmes said it well when he said that even a dog knows the difference between being kicked and being stepped upon. That is the heart of the criminal law. Yet it seems to be deliberately ignored by these guidelines, which do not distinguish between negligent injury and intentional injury. And even though we have organizations, the injury itself can be intentional.

I think I probably said enough about the offense multiple. There is other data besides the Shapiro study. It makes it impossible to use a gross overaggregated 2.0 or 2.5 multiple. Even if we could come up with multiples for specific crimes, I think crime categories themselves tend to overaggregate. There is a range of people, a dispersion of offenders. If we focus only on the mean offender, we are deliberately and intentionally underdeterring the 50 percent who are above the mean, who are more competent or more or less risk averse.

I have a number of other points that I try to

raise, many of them raised by Professor First earlier today. I do think, though, that the problem that we see throughout this is that the sentencing standards ignore exactly the variables that have been most important to the criminal law, the variables of intention, of recklessness. We don't make any of the distinctions at sentencing that the criminal law has long made for a hundred years. I think that is a major change in the criminal law, and I also think that the real- world impact of the examples I gave and three or four others that are in that memo would be to substantially reduce the penalty levels.

I think I probably exceeded my time. Therefore, I would be happy to answer any questions you have.

CHAIRMAN WILKINS: Thank you very much, Professor Coffee, for your attendance and your informative testimony and thoughtful witness submission. Of course, you recognize, as I hope everyone here does, that this is the first formal step this Commission is taking toward the promulgation of guidelines for organizations, and the distribution of material does not carry the Commission's formal vote or even informal.

MR. COFFEE: I understand that.

CHAIRMAN WILKINS: The staff and others did a very good job, I think, in producing good materials that help us identify the issues and allow you and others to comment in the concrete. I think it really has helped the informed testimony that we have received by having something to focus on.

MR. COFFEE: I want to be clear that I am not faulting the staff for their intelligence. The document shows high intelligence. I think that it does not show some familiarity with some of the issues that criminal law scholars, both in the substantive criminal law and the field of criminal procedure, would have given the staff as input had they been consulted at an earlier point. I still think that input could be valuably introduced, and my basic bottom line recommendation to you is that you combine the reasonable multiple of the greater of the gain or loss with high minimum penalties. Otherwise I think you have a system that under existing practice in most courtrooms will not be operational.

CHAIRMAN WILKINS: You may not find a majority of disagreement with that. But that remains to be seen, because we are writing on a clean slate beginning today. Thank you very much.

Let me ask my colleagues to my right if they

have any questions.

COMMISSIONER BLOCK: I have one small inquiry. Perhaps the real world helps us here. One of the points you made is the procedural difficulty in establishing loss.

On page 22 of the staff's report is a distribution of a sample of losses. I think you notice that it is really only about 5 or 6 percent of the cases have losses in the million or above, and in fact almost half the cases have losses of 50,000 and below. I think that has two implications. One is that high minimums would grossly distort the punishment in many, many cases. The other is that the complexity is there only in a very few cases, I would imagine five or ten cases every year, where there are large losses without imposing a very large burden on the courts.

MR. COFFEE: I think that you are not taking a sufficiently ex ante perspective. There is the incentive today to impose large penalties since the '84 legislation. If you change the law so that you know in those large cases, those cases involving the larger gain or loss, that you will underdeter, you will create a stronger incentive for those kinds of crimes to occur. You can't just look at the past under a different

structure and say if we modify the disincentives and we know the disincentives will be inadequate for the large case, the Allied Chemical, the Hertz, the Drexel Burnham, the Defense Procurement case, that those numbers will remain small. Those crimes will be underdeterred and the criminal law will not be a sufficient deterrent; in civil court in some cases it may be.

COMMISSIONER BLOCK: But let me go back again to the real numbers. There are maybe five cases a year historically in the million-and-over category. What do you think the stimulative effect is of the new fining? I believe there will be some effect on that, but it could be fivefold, tenfold? Doesn't it have to be something like a hundredfold for this really to be an administrative problem?

MR. COFFEE: I think you are making a mistake that I would characterize this way: it is a mistake to judge the severity of something like AIDS by the number of cases reported in 1980. I think you are undercounting by looking at historical data which was computed at a time when there were no meaningful penalties that could be imposed. Until the '84 Act the

penalties for prosecuting a corporation were so low that most prosecutors, being quite candid about this, didn't see much of a reason to punish the corporation, to indict the corporation, because you weren't going to give it much more than a slap on the wrist.

They had one more concern as well. They were subject to considerable criticism within the bar and in the public if they prosecuted the corporation and then settled with the individual defendants. It looked like a kind of plea bargaining under which the corporation got convicted and the individuals got let off.

I think you and I agree that there is a strong argument for prosecuting a corporation because the organization can better monitor its own agents than can the state, at lower cost. We have the same philosophy on that. But the reason it wasn't done was there was some professional criticism for focusing on the corporation. It was vulnerable to being called a sellout. And there were very low penalties. It is only in '84 and only more recently where the prospect of new sanctions, like restitution and probation, give the prosecution a serious incentive that this will do some good to prosecute this company, as opposed to simply

lashing a rock.

COMMISSIONER BLOCK: I was granting that there were very few and that it was in fact a result of very small penalties. What I was really asking is the question: How much stimulation there would be in the prosecution now that they have these higher penalties? Judge Breyer has a concern, in fact, that there will only be ten important cases in the United States a year that would be covered by these guidelines. And I guess you are saying, no, he is completely wrong, there may be hundreds under this new?

MR. COFFEE: I think there are ways of judging the occurrence of crime. For example, instead of looking at the data I think you have looked at, other social scientists have done self-reporting studies and they have done it actually in respect to corporate study, as in the Clinarik study where they have done it in some sections of the country. I think the better way to do it is what they did, a census of retired executives as to whether they are aware of crimes committed in the organization they worked for in a category, and they got a higher percentage.

COMMISSIONER BLOCK: You would give me your best guess. There are five or ten now?

MR. COFFEE: Five or ten what?

COMMISSIONER BLOCK: Five or ten prosecutions where the losses are over a million dollars. What is your estimate?

MR. COFFEE: Speaking as a securities lawyer, almost any case the SEC brings could have been brought by indictment. The law is that broad. We see lots of SEC actions, and the SEC knows that in those cases the penalties -- that is a unique context -- but the SEC knows that private damages plus SEC treble damage penalties are likely in any case to go well over a million. And I am sure in the particular context, like tax fraud and securities fraud, how much we use the criminal law is a matter of choice. The matter of conduct that could be called criminal is very, very broad.

COMMISSIONER BLOCK: So, to summarize it, you think this is potentially very important as opposed to an area where there are only a few large ones?

MR. COFFEE: I accept that summary. I think it is important. It is particularly important because for the first time you are going to be narrowing discretion and if you narrow discretion so the judge can't do anything that will deter, you will invite a lot

more misconduct.

COMMISSIONER CORROTHERS: I have a comment. You have given us considerable food for thought today. I think your testimony has been comprehensive. I appreciate very much your including the example of various cases. Your testimony has been thoughtful, provocative, and extremely useful, I think, to us, and I thank you for it.

MR. COFFEE: I thank you very much.

COMMISSIONER NAGEL: Any commissioners to my left?

COMMISSIONER BREYER: Do you know how many cases Mr. Lynch said?

MR. COFFEE: I am sorry?

COMMISSIONER BREYER: We just had the Director of Enforcement from the SEC. I asked him how many insider trading cases have ever been prosecuted against a corporation, criminal. Do you know what the answer is?

MR. COFFEE: I think it is probably one or two or three or four a year.

COMMISSIONER BREYER: No, it is zero.

MR. COFFEE: Zero against the corporation.

COMMISSIONER BREYER: Yes, against the

corporation.

MR. COFFEE: But what you have to look at --

COMMISSIONER BREYER: What you are saying is, it is a good idea in the future to prosecute corporations.

MR. COFFEE: I am saying that --

COMMISSIONER BREYER: Is that right?

MR. COFFEE: If I can point you to the Susan Shapiro data, which is the best data base on how securities fraud has been handled within the agency and within the courts, her finding -- not my finding, but hers -- is that the problem is the nexus between the SEC and prosecutors. It has really been only in one district, the Southern District of New York, that there has been a substantial number of insider trading cases brought. Other U.S. Attorneys find it involves a substantial investment of human capital to learn how the securities law works and to bring cases underneath that. You can find this out simply from the U.S. Docket Reporting System which shows you the rate of rejection of referrals, the informal referrals brought, and you will find that the SEC has a very low withdrawal ratio in terms of the number of cases they refer to a U.S. Attorney that are actually brought. It is one of the

lowest.

COMMISSIONER BREYER: I think in any instance in which there has been insider trading, there must have been a human being who was involved in the insider trading. I think that that person should be prosecuted criminally where he has violated a criminal law. What I don't understand is why you think that, in addition to that case, there should be a second criminal case brought. I am not saying there shouldn't. I just want to understand what your reason is for thinking that, in addition to prosecuting the human being who criminally violated a criminal law, we should also bring another case against an entity called the corporation. There may be very good reasons for doing that, but I want to know what they are.

MR. COFFEE: It is the same set of reasons that Congress has just followed in also authorizing much higher civil penalties, on the civil side, against the organization for an individual who is disobeying the organization's own rules by insider trading. It is basically the notion that the best way ex ante to deter this behavior is to enlist the cooperation of the principal, of the organization, in monitoring, because the principal is a much better monitor than is the

state, it is much closer to the situation.

COMMISSIONER BREYER: So the reason is this, which I have heard several times today, and I am just trying to elicit --

MR. COFFEE: There are two reasons. That was the first one. The second is that it is often very difficult, and this is truer in environmental cases and in corporate homicide cases than in insider trading, to identify the responsible individual. If you take the Hertz case, which was a classic mail fraud, you are defrauding an insurance company. If you went after individuals there, you would be going after several hundred ticket counter agents who over the period of years have followed a standard operating procedure at Hertz, possibly also used at other companies, of every time there was a crash report from the victim, that they went through a procedure by which they falsified the insurance appraisal and lifted it two or three times. I think that it would be a scapegoat system of criminal justice if in every case we focused on a lower level agent who was very likely responding to pressure from above.

COMMISSIONER BREYER: If they committed a crime, why shouldn't they be prosecuted?

MR. COFFEE: I am not saying they should not be prosecuted, but I am saying the ability --

COMMISSIONER BREYER: What if they didn't, why should they be?

MR. COFFEE: Two different things here. One is, it is sometimes very difficult to identify the actual decision-maker --

COMMISSIONER BREYER: Your point is well summarized this morning, and I have written down both those reasons this morning.

MR. COFFEE: The second point that I didn't think you fully picked up --

COMMISSIONER BREYER: You want the corporation because you can't go after the individuals.

MR. COFFEE: Yes, but there is a second problem, which is that the corporation can threaten a lower-level agent more than a state can. The corporation can threaten the lower-level agent, the Hertz employee at the ticket counter who falsifies the insurance appraisals on a daily basis. The state can threaten them with five years' imprisonment, but there is the one chance in a thousand that they will be caught and convicted. The employer can threaten as follows: They can say, if you don't follow our operating

procedures, you are going to be fired. And if you have one child in college and a mortgage, that is a very important threat: to be fired by your employer. So the present value of the threat that the employer can make to a lower-level agent is higher than the present value of the threat that the state can make. Given at least the indeterminacy of who can threaten more, you need to focus some penalties on the principal.

COMMISSIONER BREYER: I am just trying to get the reasons.

MR. COFFEE: I think I am arguing that you need to focus on the employer, because the employer can threaten for failure to violate the law more forcefully and more threateningly than the state can threaten for, given the low rate of apprehension for white collar crimes.

COMMISSIONER BREYER: My question is this: I take it there are two reasons, which is consistent with what other people have said, for why you might want to prosecute a corporation in addition to or other than individuals. One reason is because you want that corporation to have an incentive to put in monitoring. The second reason is because you can't find the individuals, which encompasses a lot of things that you

just mentioned, that you can't go after the individuals.

MR. COFFEE: Yes.

COMMISSIONER BREYER: If those are the reasons, why do you want to go after them criminally, that is, if in fact you are trying to encourage corporations to monitor the behavior of their executives? You are the one who is talking about a classical principle of criminal law. It seems to me if you are trying to give the corporations an incentive, what you would do is make them pay a huge amount of money when their executives do something wrong. And that leads to my other question, which is: The statute, whether you criticize these penalties for being too low, says that the maximum is twice the harm to the victim, once you get beyond the threshold.

MR. COFFEE: That or the half million.

COMMISSIONER BREYER: But we are talking about SEC violations. So you say the SEC already has authority to go three or four times that, and you are asking us to write guidelines to go after a set of cases which previously have never been brought. What you evidently want us to do is to write draconian penalties which are greater than the statute. So I want you to explain why we should go after these particular people

and how.

MR. COFFEE: I don't think I said some of the words that I just heard attributed to me.

COMMISSIONER BREYER: I mean, why not go after the table? Why not go after the chair?

MR. COFFEE: The table is not a cost bearer.

COMMISSIONER BREYER: Exactly. You are trying to get particular people to act differently but you are not going after them.

MR. COFFEE: I think your first question, if I could take these one at a time, is why use the criminal law.

COMMISSIONER BREYER: Yes.

MR. COFFEE: I am not arguing against civil penalties. I think civil penalties should be developed more generally, because they can be enforced at much lower cost to the state. That is a particular reason for civil penalties if we have them, and we do not generally have them, it is the legislative concern. If the legislature were to authorize broad civil penalties across a wide range of behavior, I think there are some arguments for using them much more liberally than we are today.

However, the concern seems to me for this

body, as an agency delegated the task of determining criminal penalties and faced with the fact that there were very few civil penalties authorized, is to use the weapons given to it, given that there aren't other weapons, you can directly say to the legislature that they should also consider greater use of civil penalties, but I don't think you can abdicate the task given of making those weapons given to you effective.

The second part of that answer. Why is the criminal law more effective? I don't know that I can give you a persuasive answer, but I think we can observe it and I think we should look at the evidence. We have seen today -- conventional wisdom among the securities bar in this town -- that Drexel Burnham would be willing to pay a hundred million to settle the charges if there were no criminal conviction. There is a threat from that penalty even when applied to the corporation, and it seems to induce very large corporate concern. The fact that I can't explain it doesn't mean that I can't observe it.

COMMISSIONER BREYER: Let me ask you another question. Now let me go from the set of cases that I think from this date have been brought. If I read the cases that you are talking about so far, they are cases

that might be brought in the future but probably aren't being brought now. If that is so -- and I am not certain if that is so -- the cases that seem to be brought now seem to be cases involving close corporations, and a lot of them involving fraud, perhaps with low amounts of money involved. So one thinks of the typical case now as involving some rather flagrant or quite seedy or fairly low-level con operation where perhaps the defendant has himself incorporated, and the whole thing is a sham or, alternatively, uses his business for some innocent and some crooked businesses, some parts. And perhaps he doesn't have a lot of money. If that is so, high-level minimums are going to get somebody who is involved in a $10,000 fraud into a situation where they are going to say, you have to pay a million dollars, which doesn't seem exactly right.

MR. COFFEE: I didn't say for all crimes. I think there are plenty of violations of the Pure Food and Drug Act where we would not want that kind of fines whether or not authorized.

COMMISSIONER BREYER: Right.

MR. COFFEE: I think if we had a case of corruption where we were dealing with a bribe paid to a senior official of state or federal government, we are

dealing with the kind of behavior that I am not worried at all about excessively deterring. I see very little utility in paying bribes. So this is information given in advance, it is fair notice.

COMMISSIONER BREYER: I am not actually addressing that. We have to have some sense of proportion, but I don't know how that quite works. But the thing I am getting at is, you have an interesting proposal for probation. Professor Cass or Commissioner Cass this morning pointed out the set of defendants where they are corporations, not individuals, and he said, I think, if I interpret him correctly, that to impose a supervisory probation on a firm like that is likely to be extremely complex. It will involve probation officers going to these perhaps rather small companies in back rooms somewhere that may or may not be able to respond to monitoring, and no one knows how to set up a monitoring operation for such a firm. In other words, the actual defendant is not the type of defendant that you had in mind when you wrote your supervisory probation proposal. I want to get your response.

MR. COFFEE: It is your term, "supervisory probation." I think we had two different sets, three or four different sets of probation conditions.

COMMISSIONER BREYER: Yes, we did.

MR. COFFEE: When we start talking about the small company, I don't think there that we have the independent board of directors that we are essentially trying to harness. We do have some conditions that are much more usefully employed in the case of a large publicly held firm and which are not very useful in a corporation. The procedures for having a board report and a board study that make no sense when two-thirds of the stock is owned by one family. We are not dealing with an independent board of directors. I agree that there are broad differences between the closely held firm and the public corporation. I think our report could be improved on by indicating more clearly that some of these conditions make more sense in one context than in the other.

But in the context that you are talking about, the small midnight-toxic-dumping company, which has repetitively engaged in toxic dumping because maybe its management is risk averse, whatever, I think in those kind of conditions you could very easily set up procedures dealing with the ingress and egress of certain toxic chemicals and materials.

You are dealing with kinds of behavior, kinds

of impositions of restraints, that the SEC and other federal agencies have used on a regular basis. The SEC consent decrees, that they have used civilly in many contexts, deal with audit committee procedures that are really a model for what we are talking about here. We have got ten to fifteen years of operating history with SEC consent decrees that show that at least some kinds of imposed restraints can make sense for some kinds of corporations; indeed, they have some deterrent value.

COMMISSIONER BREYER: It might make sense if you take some of your ideas and others that have been put forward here and write up a provisional set of guidelines incorporating them. I think they are more consistent than you might think. I mean, this notion of monitoring comes across nonstop. And if you did that, wait and see what happens. It may be that more of these prosecutions are brought; it may not be.

MR. COFFEE: I do think that the criminal justice system should be approached from all angles. I think the prosecutors should be influenced, sensitized. The determination of prosecutorial priorities seems to me something that should be a legitimate public policy issue.

COMMISSIONER MacKINNON: Professor, first of

all, I would like to say I don't agree with you when you said that there isn't any mechanism for the United States Attorney to get the evidence on these, and the prosecutors wouldn't be interested. You are jumping into the future. My experience is to the contrary. It isn't like you run into down on the Eastern Seaboard here and a few places. When you get out into the hinterland, they are very interested in some of these frauds, and they will take the time. Particularly when you don't have any more corporate cases than we do, it isn't going to take a lot of time.

Secondly, you said that the guidelines, one of the drafts in there, do not consider the public effect. Is there any way to compute that? How would you compute that?

MR. COFFEE: I think you can't quantify it, you can't quantify the injury to the country if a Cabinet member were found guilty of taking a bribe, the Spiro Agnew kind of case, but it exists even if I can't quantify it.

COMMISSIONER MacKINNON: But if you are going to put it into the basis, you have to quantify it some way, don't you?

MR. COFFEE: I think you can have a minimum

fine for that type of case.

COMMISSIONER MacKINNON: A minimum?

MR. COFFEE: A very high minimum fine. Instead of having what we have here, based exclusively on the property loss.

COMMISSIONER MacKINNON: But you would agree it couldn't be computed by economics?

MR. COFFEE: I think the attempt to compute that by an economic approach is probably illusory. You are going to have to make a ballpark estimate as to just how we rate this crime on the scale of overall offense data and how hard it is to detect if you wish to get to that question at all.

Can I emphasis a comment we made at the outset. I don't mean to say, that prosecutors don't care about corporate crime. I say having talked to them and I have war stories from having been on the other side of recent cases, that they have no ability to get information about the damage caused by the offense. They are dependent only upon victims walking in. And if we have a toxic dump case, we have an environmental injury, a small percentage of those people who are victims are going to come in, even with an order of notice, to tell the prosecutor. So we aren't going to

be able to get adequate information about what the true loss was. That is why I doubt that the system of computing the social loss caused by the crime can be easily implemented.

COMMISSIONER MacKINNON: They will have a very elaborate record of victims before they ever prosecute the case. If they don't, they aren't doing the job as United States Attorney.

You say it is difficult to discover the individuals in corporations who are guilty of crimes. How are you going to prove criminal intent if you don't have an individual?

MR. COFFEE: There is an answer to that and it came up recently in the First Circuit, in a case called Bank of Boston, which has redefined corporate mens rea. It is a rather strange case and I don't want to hang everything on it, but it is now possible, based on several precedents, not just the Bank of Boston case, to take knowledge held by different individuals within organizations and aggregate it. So if the organization has different actors who know some of the facts, you can aggregate that, even though no one person has knowledge of sufficient elements.

The fact pattern in this case -- people are

looking puzzled -- involves violation of the money laundering statute in which different people were taking to different -- one person was taking a number of different deposits to one bank teller.

COMMISSIONER BREYER: Is it in the Bank of Boston case that they pleaded guilty?

MR. COFFEE: What?

COMMISSIONER BREYER: I thought they pleaded guilty.

MR. COFFEE: It is a First Circuit opinion convicting, based upon knowledge --

COMMISSIONER BREYER: Didn't they plead guilty?

MR. COFFEE: It is available on Lexis within the last two years and it deals with individuals having knowledge -- let me give you a better illustration than the Bank of Boston. Take the Ford Pinto case and a lot of reasons why maybe we do not believe the Ford Pinto should have been prosecuted. But would we have been happy with trying to identify the individual decision-maker in that case? We would wind up in a committee room with fifteen civil engineers, five cost experts, two accountants and other people, all of them trying to design a gas tank over a five-year period.

And I don't think you can identify with the kind of assurance necessary to attach the stigma of a criminal conviction.

COMMISSIONER BREYER: If they committed a crime, why aren't they prosecuted? You say they are under economic pressure. Do you think somebody who goes out and robs a grocery store down here, who comes in and says he didn't even have a job, isn't

MR. COFFEE: I am saying we have a limited ability to deter them if we consider the total set of pressures they are under.

COMMISSIONER BREYER: What about the pressures that the robbery people are under?

MR. COFFEE: We can change the pressure there by putting more pressure on the organization. If you think ex ante you put the pressure first on the organization, the organization will monitor rather than induce involvement in questionable activities.

With respect to the Ford Pinto case, I think that it would be ethically troubling to go after a collective kind of decision, such as the design of a gas tank that was quite dangerous. I think it is much safer and fairer to go after the entity than to try to focus on twenty different individuals, some of whom are taking

orders from above. Someone above says design this for $30. Someone below says it is going to be dangerous. But maybe the two of them didn't share those same perceptions. I think it is safer and fairer to go after the organization.

COMMISSIONER MacKINNON: That is what they did and, as I recall the case, and I followed it very closely because I knew the fellow that was prosecuting it, it seemed to me that in that case that they had very concrete evidence as to the intent. It didn't stand up because Chevrolet was doing the same thing for the same reason.

MR. COFFEE: I think you get that very concrete evidence by finding out what thirty or forty different people might know in the design process. Going after just one person or charging a conspiracy, I think uses the criminal sanction against people who may have only marginal culpability.

COMMISSIONER MacKINNON: I would have said that the chief engineer who put the final touches on the plan for the car when they designed it would certainly, if you are looking for some individual, have been as good a person as any you could find, provided there was some criminal intent below it, which didn't prove out.

MR. COFFEE: I am not arguing against individual liability when you are confident of it. I am saying that there is a danger of a scapegoat system under some circumstances, and I think you should focus on the entity more generally from an ex ante perspective to shift the pressures.

COMMISSIONER MacKINNON: You say there is no difference between negligence and intentional misconduct.

MR. COFFEE: Under these guidelines. I think there is tremendous difference in the history of the criminal law.

COMMISSIONER MacKINNON: Negligence doesn't figure into intentional misconduct at all?

MR. COFFEE: Let me go back and see where we parted company. I am simply saying that under these guidelines that focus on the property loss, they do not distinguish between a property loss that was caused indirectly, possibly even not foreseeably, versus a property loss that was deliberately caused.

I think there is a difference, to give two very simple examples. Suppose twenty years ago General Motors decided it was in its interest to assassinate Ralph Nader because he was hurting their reputation. If

we look at these guidelines, we would find that the property loss there was the actuarial value of Ralph Nader's life expectancy. If we were even in the civil process, there would be huge punitive damages. I think that we should have guidelines that focus on the fact that some crimes are intentionally caused. Judge Breyer obviously is displeased by that comment --

COMMISSIONER BREYER: No, I am not displeased. This is something I guess I should know. It is in the area of how the criminal law works. I am used to thinking that the criminal law is almost always, I mean not 100 percent but it is almost always, used to get to an individual who is morally as well as legally responsible for doing something that is bad. That is why we normally have criteria like intent. You have to intend to do this thing. It seems to me in most instances there either is a human being in that corporation who had that bad intent or there isn't. If there is, you should be prosecuting him, unless you can't find him. I agree maybe he is in South America. But if you know there is no such person, if you know there is no individual in that corporation who had that bad intent, then I really don't understand why you are prosecuting some entity that exists on paper that is

like a table or a chair or a safe.

MR. COFFEE: It is like lashing the rock. There is a phrase in Plato you would be happy with: lashing the rock. Retribution doesn't work.

COMMISSIONER BREYER: Exactly. Either there are individuals who have the bad intent or there aren't?

MR. COFFEE: I am not arguing retribution or just deterrence. Others might; I am not. I am saying we can deter more of this misconduct, as we have since 1909 in the New York Central case, by the criminal law against organizations and use sufficiently large penalties to give them incentives for --

COMMISSIONER BREYER: If we used the criminal law against negligent drivers, you would have fewer negligent drivers. But we don't use it against negligent drivers.

MR. COFFEE: We do sometimes in extreme cases.

COMMISSIONER BREYER: Normally we don't. I am sure if you use the criminal law against ordinary householders who don't remove ice from their walk, I suppose that would be a deterrent too. But my question is this: I am asking you, as a criminal law professor, which I am not -- I am not asking whether there is more

deterrence, I am sure there is -- I am asking you what the theory of the thing is. Why is it that the criminal law, which normally is used to go after people who have a certain bad intent, could be used to go after an organization where that intent does not exist in the organization?

MR. COFFEE: Let's start from a starting point.

COMMISSIONER BREYER: Explain that.

MR. COFFEE: No one is talking about expanding the parameters of the substantive criminal law. No one here is talking about using the criminal law against the simply negligent individual who doesn't get the ice off the sidewalk by the 10 a.m. traffic. We are talking about existing offenses that generally have mens rea levels. I am saying when we get to the penalty- level determination, we are simply focusing on the property lost. It is relevant, I think it is extremely relevant, to focus on whether that property loss occurred in an unforeseeable manner, which is still covered because it was a property loss directly caused; in a foreseeable manner and a foreseeable manner that was intended. I think that is the kind of continuum of moral responsibility that criminal law and tort law

share in common, because the tort law would also distinguish negligence from intentional misconduct. It would impose punitive damages in that case. I think if we don't make that distinction, we go back to Holmes's point, that in terms of the moral common sense of the law, everybody distinguishes, including a dog, between being kicked and stepped upon.

COMMISSIONER BLOCK: Does a corporation distinguish between those two? I think the question, if I understand Judge Breyer's concern, which I share this concern about anthropomorphizing these organizations. The intent issue is an issue about the agents. The principal here is an inanimate entity.

MR. COFFEE: We have already heard the concession that sometimes the agent is not there. The agent is dead. The agent has disappeared and left the jurisdiction. Or there are cases that we simply know there is an agent who intended this but you can't find him, he has disappeared, he has vanished. In those cases it seems to me that it is still self-evidently relevant, whether the injury was caused in an unforeseeable manner, whether it was caused in a foreseeable manner that satisfies the law of negligence or, up to the last level, whether it was deliberately

intended. Because even the law of torts, which is less concerned with moral claim and more concerned with loss compensation, would award punitive damages in that case. I think the criminal law, which is more concerned with intent, more concerned with moral blameworthiness, should be at least as willing to accept the notion of special high fines for intentional misconduct as the law of torts.

COMMISSIONER BREYER: So we have a posit. Take the set of cases where you could indict some individuals for a crime and these individuals worked for a corporation. You might want to indict the corporation as well, for two reasons.

MR. COFFEE: Plea bargaining dynamics.

COMMISSIONER BREYER: I want to be a little more theoretical than practical. Why in terms of the aims of the criminal law might you want to do that as well as the individuals? And one reason would be that the corporation would have more money to pay back, say, their victims?

MR. COFFEE: Sure.

COMMISSIONER BREYER: And the second reason might be that it would put additional pressure on the corporation to develop a monitoring system.

MR. COFFEE: Or on other similarly situated corporations.

COMMISSIONER BREYER: Yes, to develop monitoring systems. And, indeed, there will be another set of cases where we could indict those individuals and the corporation but we can't find the individuals, "find" broadly defined. There the corporation might be the defendant alone. But what is important to us, I think, for punishment purposes is that we have the almost broad consensus on those two basic reasons. The reason the corporation is there, whether it is in the first or second set of cases, is the incentive to introduce the monitoring system, and because that corporation may have additional resources to get a penalty, say, for restitution of victims.

I have been quite a pest with a lot of witnesses on this point, but I think there is a consensus pretty much that that is the purpose of it. If that is the purpose of it, I think that allows us to write a set of principles.

COMMISSIONER MacKINNON: What is your 1909 citation?

MR. COFFEE: I am sorry, I didn't hear you.

COMMISSIONER MacKINNON: What is your 1909

citation?

MR. COFFEE: Oh, the Supreme Court established the rule on corporate criminal liability in the New York Central-Harlem Rail Road case in that year when they said that a corporation is liable for any act of an agent committed in the scope of his office and with an intent to benefit the corporation. That is the rule of basically vicarious responsibility for criminal law purposes for the acts of the agent intending to benefit the corporation.

COMMISSIONER MacKINNON: Thank you.

COMMISSIONER NAGEL: Mr. Gainer?

COMMISSIONER GAINER: I think in the last ten minutes there has been far less difference than meets the ear.

As an aside, I would like to note that in rough count I think about 80 percent of existing federal statutes require only a Model Penal Code recklessness standard as opposed to anything higher. So specific intent is the exception rather than the customary level of culpability.

What I would really like to say is simply that: Like Commissioner Corrothers, I thought your testimony here today has been particularly helpful and I

thank you for it.

MR. COFFEE: Thank you.

COMMISSIONER NAGEL: Thank you very much. You have been enormously helpful, and we appreciate all your efforts on our behalf.

(Witness excused)

COMMISSIONER NAGEL: Professor Orland, from the University of Connecticut, School of Law.

L E O N A R D O R L A N D, called as a witness, stated as follows:

MR. LEONARD ORLAND: Good afternoon. My name is Leonard Orland. I am a professor of law at the University of Connecticut Law School. I have been there for about fifteen years. Prior to that, I practiced antitrust law for about ten years in New York City. For the past ten years at least, my field of teaching and publishing has been sentencing and corporate criminal liability. Hence, it might stand to reason that I have an inordinate interest in the subject today: organizational sanctions.

I also approach this with an extraordinary

sense of humility and modesty. I am not sure how much I have learned and how much I can convey. Now, the goal is just-punishment treatment, and it is easier to give that slogan than to give concrete results, or about corporate criminal liability.

With Harold Tyler, about a year ago, year and a half ago, we put out a two-volume book on prosecution of the publicly held corporation. I think that Judge Breyer would have an extraordinary learning experience in the last -- no, I guess throughout the day today, trying to derive, I think, not what the guidelines should be but what is this basis for holding inanimate, nonthinking creatures, which we call persons, legal persons, criminally liable. And I think, with admiration both to the questions and the answers, that you have really gone a long way toward synthesizing that.

Understand, as I think you do, that the United States is the exception, not the rule, when it comes to corporate criminal liability. Throughout mainly Europe there is no such thing as corporate criminal liability. Individuals bear responsibility, not organizations. The Common Market Committee on Law has been debating for some time in the last two years in

particular about whether that law rule should be changed and whether the Continental system, particularly the Common Market, should move toward the British model, the American model of liability of the corporation. The United States Supreme Court and the United States Congress have been fairly clear. They don't see any ambiguity. They don't see a problem. They think it is fundamentally important to impose criminal sanctions on corporations.

Let me back up and try to lead into the two principal points that I want to explore with you. Those points are: If you are going to have organizational sanctions, what organizations should be subject to those sanctions?-- a question that has been skirted at. Ten corporations a year, why bother? And if you are going to have something other than fines. Why? And how should they be structured?

First, as to the question of what animals should we deal with and why, about ten years ago I was reporter to the Second Circuit Committee on Sentencing. There were some marvelous people on that committee: Tyler, Frankel. I had the pleasure of writing books and articles with both of them since. In that capacity I attempted -- this was midseventies -- to use the federal

judicial statistics and get a data base on corporations convicted of crime. I came up, not surprisingly, with the same kinds of problems that the staff had this time. It is very hard to separate all of these entities, these organizations, and see what they are. I don't think that this Commission should substitute convenience for policy. It is more convenient, given the data, to look at all the organizations. Indeed, the federal criminal code distinguishes between "individuals," defendants who are "individuals," and defendants who are "organizations." But organizations under federal criminal law encompass what I would suggest to you is a variety of creatures. The small partnership or corporation, which, as you suggested, Judge Breyer, may be the alter ego of criminals involved in manipulation of the law, in my judgment share very little in common, for purposes of articulated sentencing policy, with a multibillion-dollar multinational, publicly held corporation. The nonprofit organization -- the American Hospital Association, National Blue Cross, the Red Cross, what have you -- shares very little in common with a labor union, and yet they are both organizations.

As I understand it, the statistics, the studies, the proposals on the table right now, deal with

all organizations. I think that is a mistake. I think that you should modestly begin to step back and at least give considered deliberation to that issue.

The public concerns, as I see them, are not about some small corporation or partnership that is a crook that happens to be prosecuted and end up a judicial statistic as an organization, one of those 300 that you alluded to, Judge Breyer, on an annual basis.

I think that the public concern and disquietude, as I read it, rather is over the large, publicly held corporations whose misconduct is only in part measured by the harm of the discrete incident. It is the fact that, for example, the Defense Department's thirty largest suppliers have all either been indicted or are currently under criminal investigation that causes a public perception, as an Associated Press survey reported last week, that roughly 70 percent of Americans think that the federal system of government is not honest, is corrupt.

Now, I don't -- I think I have my numbers right. Let me correct: Seven out of ten Americans think illegal payoffs are common in the federal government, an AP general survey.

Now, they may be quite wrong. But it seems

to me that that has to be a cause for serious concern. That is a concern that is not measured by whether there are ten prosecutions a year.

I will leave a few moments for specific suggestions, because I think you have had a lot of policy analysis and probing of the underlying issues. I suggest, in the first instance, that the Commission ought to seriously think about devising organizational sanctions to deal with the large, publicly held corporation. I think that the concern about the large, publicly held corporation is grossly understated by how many criminal prosecutions there are, for a number of reasons.

One of them is that the frequency of prosecution of a large publicly held corporation has, in the past several years, declined materially. At the same time Congress in 1984 and 1986 and in 1987 passed whole new varieties of criminal statutes enlarging circumstances under which large publicly held corporations can be criminally liable. So I think it is far too soon to determine how much corporate criminal prosecution there will be in the United States.

But more importantly, the large publicly held corporation is first among equals of the citizens of the

United States, with disparate power. For example, the 500 largest corporations in the United States have collectively $1.8 trillion in sales, $1.5 trillion in assets, employ more than 14 million people, and account for roughly half of the gross national product. That is 500 corporations.

At the same time, roughly 10,000 corporations in the United States, out of several hundred thousand corporations in the United States, are reached by the line drawn by the Securities Act of 1934 for large publicly held corporations, namely, they have 500 or more shareholders and at least $500 in assets.

If you start thinking about having that as a subset of an entity to be called an organization for purposes of an initial go-around of organizational sanctions -- I am not proposing for the moment that there be no organizational sanctions against others; I am simply saying that I think it makes the most sense to concentrate in the first instance on the large publicly held corporation -- then the question becomes: How much cause is there for concern about the conduct of these largest of the large corporations that account for so much of the gross national product?

In 1978, while I was working with the Second

Circuit Committee on Sentencing, I calculated the conviction rate of the hundred largest corporations in the United States, and I found a roughly 14 percent conviction rate. That is, 14 of the 100 largest corporations on the Fortune 100 list had felony convictions in that year.

In 1980 I served as a consultant to Fortune Magazine, which attempted to look at all the corporations who were on the Fortune 1000 list during the decade of 1970 to 1980. They found -- this is by writing to the corporation, it is not by formal inquiry -- a roughly 12 percent conviction rate, and a surprisingly high recidivism rate.

I think that one of the things that the staff could do, should do, has not, so far as I know, yet done -- subject to correction; I will be glad to be corrected -- is to reach out and look not at the relatively impenetrable federal judicial statistical data base but reach out and look at the 100 largest, the 500 largest corporations, and then, surveying the EPA, the IRS, the Antitrust Division, etc., and the corporations themselves on a voluntary basis, find out the extent to which the largest of the large corporations have (a) criminal convictions and (b)

recidivist criminal convictions. My own sense is that there are surprisingly high numbers of repeat offenders in the largest of the large corporations.

So my suggestion is that in the first instance it makes the most sense, if you are going to come up with -- I don't see, frankly, much sense in coming up with discrete organizational sanctions where the primary subject is a small partnership. I think that can be adequately dealt with under existing law with very little pressing need for organizational statutes to deal with that case. And, Judge Breyer, you are quite right, those are most of the cases. But it depends on how you define "most of the cases." Most important, most frequent statistically, percentage of all cases? Or percentage of the gross national product accounted for? You come up with quite different results.

So deal with the large corporation, I would say, in the first instance, both empirically in terms of study and in terms of formulation of policy sanctions.

What would I do? What suggestions do I have for you with regard to what sanctions to apply?

First, as to fine levels, while I am not sure that I would go as far as Professor First and say

that the size of a corporation should be the index of the fine imposed, I do think that the contrary position articulated by the first witness this morning is a bit troublesome to me, particularly since I think Congress decided otherwise. The factors to be considered in section 3572 for imposition of a sentence of a fine, subsection (a)(7), declare: "If the defendant is an organization, the size of the organization"-- Congress has already legislated on the question of the relationship between organizational size and level of fine, and I don't think that it is appropriate as a policy matter to backtrack from that.

As to sanctions other than fines and the question of probation: Again, I think that the question of how you deal with probation is less than clear for a number of reasons.

First, organizational probation, in my judgment, is a statutory word but it is really a misnomer. What you are talking about conceptually is a coercive criminal remedial order, a concept unheard of prior to the 1984 legislation, because, prior to the 1984 legislation, probation, which developed relatively late in the federal system, in the 1920s, was an adjunct to a suspended sentence. But Congress in 1984 changed

those rules and Congress said probation is an independent sentence authorized in all criminal cases except where prohibited. And when you go to look at the circumstances under which probation is prohibited, Section 3561, one sees that probation is prohibited where prohibited explicitly but is prohibited for individuals in Class A and B felonies, but not for organizations in A and B felonies.

So that Congress, when it spoke of organizational probation, insofar as it did so, made no effort to reduce probation to a lesser level, to a supplement, to a fine, to some subsidiary role in the criminal justice system. Indeed, I think that a fair reading of the legislative history --and Commissioner Gainer and I have been involved more than once in that legislative effort as well as the legislative history -- that a fair reading of the legislative history of the '84 legislation is that Congress intended full, effective use of probation.

Now, understand the tables were turned. Individuals want probation because they don't want to go to prison. Corporations don't want probation, because they want to pay the fine and get it over with. But the fact that the defendant chooses one over the other is

not the prime concern. The prime concern is what is the most effective way of dealing with corporate crime. And, in brief, my suggestion would be that corporate probation, a coercive remedial order, should be the sentence of choice in all cases involving large publicly held corporations, coordinate with the fine.

I probably have something to say of interest or not of interest on almost every question that the Commission raised in its introductory materials, about a dozen questions, as well as many raised by the discussion materials, but I think it is best to respond to your questions and not to go on. I hope I have given you some helpful suggestions.

CHAIRMAN WILKINS: Thank you very much, Professor Orland. I am sorry I missed some of your oral testimony, but I will have a transcript as well as the written testimony.

MR. ORLAND: I am going to try to have written remarks by the time of your next meeting.

CHAIRMAN WILKINS: We may have our court reporter transcribe it before then anyway. In any event, thank you very much.

Let me ask if to my right there are any questions.

COMMISSIONER BLOCK: Professor Orland, I share your view of the impenetrableness of the federal judicial statistical system, but I am wondering what you think we would gain from this other approach, if taken, of the top 500 that we don't already have in the survey of sentence of corporations?

MR. ORLAND: My sense is you would have a more complete answer to the kinds of problems that Judge Breyer was raising. If there are only ten, why should we bother? Ten defendants. And I think that if you look back over the data that is available that has not been collected and systematically portrayed of convictions of the largest of American corporations, that might help you reach a considered wise policy judgment on whether you should be acting and how. That is my point.

COMMISSIONER BLOCK: It sounds very good. I am trying to place it. When the staff prepared the study that you see in these documents, they took the whole list of named defendants over that time period and they had the actual names. These are in federal court. They had the actual names. They did a machine search and they also did a manual search and looked through all the names. I guess I am at a loss to figure what we

could gain in terms of relative numbers. Are you suggesting that there are many more corporations that have been convicted in the federal court, large corporations, than we have, and the staff has somehow missed them?

MR. ORLAND: The staff study was of a limited number of years. It took as its point of departure something in the federal system. I am suggesting taking a larger longitudinal base and a smaller selectivity, the hundred largest corporation, the 500 largest corporations, and array criminal convictions of those, in an effort to convince you or unconvince you of the wisdom of proceeding discretely in the first instance against that array of offenders.

COMMISSIONER BLOCK: I think I know where you are going but I am not sure. You presented some information about how frequent the convictions were of the top 100, top 1000 Fortune firms, which doesn't seem consistent with what we have observed at the federal level. So it is your suggestion that if we look at the top hundred, top thousand, top 500, whatever, that we would find many more convictions, they would just be split between the state and the federal?

MR. ORLAND: No. I think the convictions we

talk about are primarily federal, but it could be spread among the states as well.

COMMISSIONER BLOCK: But to get to Judge Breyer's point of the ten per year, I am still mystified. Have we missed something?

MR. ORLAND: I guess I will put it this way. Ten per year out of -- what is it, 40,000 plus? -- sounds like a pretty small number and perhaps a waste of time. But the ten per year, each of the last ten years, arrays a hundred corporations which account for a third of gross national product of the United States. Then it seems to me you have a somewhat different focus on whether it is important or not to go after this entity and how. That is the best I could do.

COMMISSIONER NAGEL: You mentioned, Mr. Orland, that the size of the corporation should be a factor.

MR. ORLAND: I am saying Congress said so.

COMMISSIONER NAGEL: And I think you said, as well, it would be a mistake not to differentiate the penalties according to the size and perhaps the type of organization. What I wonder is if you could elaborate a little bit on how you might take that into account in fashioning an appropriate sentence. That is, let's

assume for the moment that you should take into account size or type. Then in what way do you take it into account? What do you do with it?

MR. ORLAND: I am hesitating only because I am not sure of what my answer is. Professor First suggested that two offenders, same offense, one is ten times larger than the other, a larger fine for the larger. I want to get to that, but I don't think I can. I think that the best that I can do in terms of suggestion to you is that the statutory instruments, twice the gain or twice the harm, are soundly conceived by Congress, and that a sentencing judge, in fashioning how much up to twice the gain or twice the harm, which is the maximum, should appropriately take into account the size of the offender. Congress has said no less. It has been explicit on that point.

COMMISSIONER NAGEL: I can understand the rationale behind the argument the size of the corporation should affect the size of the fine. On the other hand, I am not sure how persons advocating that deal with a situation where you might then, by virtue of that kind of system, create an incentive for the small corporation to engage in the large criminal acts.

MR. ORLAND: OK. Oh, the other end of the

spectrum. I think that that can be adequately dealt with under existing law with twice harm/twice penalty. That is, I am certainly not suggesting that smaller corporations that engage in large harmful or large profitable conduct should be underpunished. But if the small corporation engages in conduct that does not reap substantial value and does not cause substantial harm, then that corporation should not be, I guess, overdeterred in an analytic language that I am uncomfortable with.

COMMISSIONER NAGEL: I guess it gets sticky when we try to plan it out, and that again you can have a situation where you have a large corporation that will essentially create smaller offshoots to do its toxic dumping, etc. Once you take into account size, I think you create the potential for a manipulation of the system, although, as I say, I understand the rationale.

MR. ORLAND: I think that exists, piercing the corporate veil and other devices. If the courts are not remedying this to deal with that, I think you can't go back to a square that Congress has already covered. After all, when you are dealing with organizational fines, Congress only said one thing, and that was: Take size as well as the conduct of the corporation in

disciplining, etc., into account. So it seems to me that you have a mandate to implement that policy decision of Congress.

COMMISSIONER NAGEL: Let me move to a second suggestion, which has to do with corporate probation. If I heard you right, you suggested that probation should be the sentence of choice for all large publicly held corporations.

MR. ORLAND: Yes.

COMMISSIONER NAGEL: Could you elaborate why that sentencing choice? What purpose would be achieved? What aspect of probation would you be trying to maximize? Is it the monetary function? Is it the deterrence function? Is it an attempt to correct management problems? What end should mandated probation have?

MR. ORLAND: I think, without trying to get into the sloganeering aspects of shortening the complicated goals of criminal justice to single clauses or single phrases, that what you would hope to accomplish by a coercive remedial criminal order, which Congress called corporate probation, is to try to take steps to prevent the offender from committing the offense in the future and to try and take steps to

prevent other corporations from committing those offenses in the future.

I think that after Watergate, the questionable domestic and foreign payments that led up to Foreign Corrupt Practices Act are a simple demonstration that these kinds of orders, appointing of audit committees -- the Hutton case is another more recent example -- can be very, very effective.

So, to the extent that you believe that it is possible to deter others and reduce recidivism, I think those are traditional admirable goals.

I was particularly troubled by the first witness this morning who, addressing himself, I think, in response to a question about recidivism suggested that even if the corporation has a prior conviction for the same offense, that all that you should do then is incrementally fine and not think about coercive probation. I think that is mistaken.

COMMISSIONER NAGEL: Thank you.

COMMISSIONER BREYER: I think we are making progress.

MR. ORLAND: I hope so.

COMMISSIONER BREYER: I have one comment, I guess, and two questions. I am not certain about these

statistics that show that people are upset about corporate crime. Yes, of course they are upset about corporate crime. Of course, we are upset about corporate crime. That is why the one area of change in the guidelines that we have published so far is to increase the penalties for white collar crime.

MR. ORLAND: I agree.

COMMISSIONER BREYER: Insider trading.

MR. ORLAND: Absolutely.

COMMISSIONER BREYER: And fraud, because we found differences, that fraud was treated more lightly than theft.

MR. ORLAND: I think that those will begin to have the potential for having very dramatic impact on how this particular subclass of individuals is sentenced.

COMMISSIONER BREYER: Exactly. My reaction always when I hear about corporate crime is, find out who did it and prosecute them. And I doubt that the individual, because I know I didn't think this way, when he thinks of corporate crime is really distinguishing between whether the individual is being prosecuted or the corporation, as long as someone is being prosecuted. And, in a way, prosecuting the corporation, if there is

a choice, is worse, because it could be a cop-out.

MR. ORLAND: Right.

COMMISSIONER BREYER: That is, the individual may be home free. And that is what we have heard. Now we are just focusing on this narrow question of going after the corporation and we don't want it to be a cop-out.

MR. ORLAND: Quite right. I did want to say one thing, Judge Breyer, not to repeat the exercise which I thought you went through very constructively with the other witnesses, but there is a body of learning out there called organizational theory and organizational behavior. Herbert Simon of Carnegie-Mellon won the Nobel Prize for his work on administrative behavior. I found it singularly curious that we have proposed organizational sanctions premised on one body of economic learning, optimal penalties, with which I don't happen to agree, while at the same time totally ignoring the body of literature that deals with organizational behavior, organizational theory, organizational conduct. We have advanced a long way in terms of theoretical knowledge in the last twenty years, one of which is to understand that large organizations work by subsets of goals and that middle managers pursue

goals and shield information from their superiors that they think their superiors do not want to know, and that creates all kinds of problems in terms of attaching individual liability to high managerial agents.

COMMISSIONER BREYER: Let me fold up the two things that you suggest to me and see if this is possible. You might divide the organizational sanctions into three parts. The first part would be those corporations which are basically instrumentalities of the crime.

MR. ORLAND: Yes.

COMMISSIONER BREYER: I would think the remedy of choice would be to dissolve them?

MR. ORLAND: Yes.

COMMISSIONER BREYER: Where there are those instances.

MR. ORLAND: Absolutely.

COMMISSIONER BREYER: Then the second set would be the wholly owned corporation, but we can't say it is solely an instrumentality of crime, it may be used for good as well as for evil.

MR. ORLAND: Sure.

COMMISSIONER BREYER: And it seems to me there the remedy of choice, the sanction of choice,

would be treated as an individual.

MR. ORLAND: Yes, I agree with that. Absolutely. I am with you.

COMMISSIONER BREYER: Then the third, which is now the most interesting one, which we have now said is not just a past --

MR. ORLAND: Excuse me. Those two take care of the largest number of your offenders.

COMMISSIONER BREYER: That's right, and now we are at a small number of offenders and it has a certain future potential.

MR. ORLAND: Yes.

COMMISSIONER BREYER: And there where we are, I think, is in developing a remedy. We are pretty much in agreement with what the object is, except there will be a set of instances where the object is to get restitution. That is fairly easy. But the most interesting objective is the development of adequate monitoring, both as incentive to others and to that firm, and that is almost uniformly probation. We really have three weapons. The first we have talked about exclusively is the fine. Oh, by the way, we might divide that set of organizations into two categories: those that are publicly held but small and those that

are publicly held but large.

MR. ORLAND: Quite right.

COMMISSIONER BREYER: Let's focus on the publicly held but large. As to those, we have three basic weapons.

The fine. The trouble with the fine is the statutory limits are too low, because if they really follow the theory through, it is going to be in many cases more than double the harm.

MR. ORLAND: On the other hand, in some cases double profit may be substantial. Insider trading cases suggest that.

COMMISSIONER BREYER: Insider trading maybe. We don't know. We have this weapon which has a statutory limit on it.

MR. ORLAND: Yes.

COMMISSIONER BREYER: Then the second weapon which we have is stigma.

MR. ORLAND: Yes. But not to be understated. I think that Professor Coffee's comment about Drexel Burnham and settling a civil case to avoid a criminal case, even if there is no incremental financial detriment to a criminal case, is well taken. The stigma, as E. F. Hutton discovered, of a felony

conviction is enormous.

COMMISSIONER BREYER: And then we have to figure out what that is, and what we know about it. Then the third, which is the sort of unknown area, is what you call probation, but now it is becoming clear to me that the trouble is that probation sometimes sounded like a buzzword.

MR. ORLAND: Yes.

COMMISSIONER BREYER: Because I kept thinking of it as an empty box. I kept thinking of probation as a way to do something. But what is the something? You can use probation in order to get the corporation to do what? Now you are saying that what the probation could be is probation as a condition of the corporation -- and now we have a blank, but we fill it in with something to do with auditing or something to do with continuous monitoring.

MR. ORLAND: Yes.

COMMISSIONER BREYER: And those things remain to be fleshed out. We have to see what happens. And you can progress from there, being more and more specific, which has the advantage of being specific but the disadvantage of speaking from ignorance. We have to be able to find out just what it is that we ought to

fill in. I have now made an outline.

MR. ORLAND: You certainly have. My experience in testifying before committees and agencies is not that extensive, but I must say that for me this is remarkable. I have never seen an instance where many persons voice concerns about them for the moment and then actually end up the same afternoon with at least a starting point, a blueprint, for what is new. I am not saying on close analysis you might not find shortcomings and deficiencies, but I am saying I do not disagree with anything you just said. As a matter of fact, I support it, I agree with you.

CHAIRMAN WILKINS: Thank you. Questions?

COMMISSIONER MacKINNON: You don't want the guidelines to deal with small corporations.

MR. ORLAND: Not in the first instance. I would prefer in the first instance directing our attention to others. Although, as Judge Breyer has indicated, maybe what we do is do it simultaneously. It is not that I don't want to deal with them. I don't want to deal with them in the same way that I deal with large publicly held corporations, because I think they are different.

COMMISSIONER MacKINNON: That was my point.

If you weren't going to deal with them, the guidelines are still going to make them subject to penalties.

MR. ORLAND: Yes. It is not that I don't want to deal with them. I don't want to deal with them the same way that I deal with large multibillion-dollar corporations, because they are not the same. They present discrete problems.

COMMISSIONER MacKINNON: You said that your cutoff was 500 or more shareholders and $500 in assets.

MR. ORLAND: Five million.

COMMISSIONER MacKINNON: Yes.

MR. ORLAND: I am not saying that that is the one you should adopt. I am saying that is an SEC dividing line.

COMMISSIONER MacKINNON: You said $500.

MR. ORLAND: I am sorry, I did not mean to. I meant $5 million in assets. That's the Securities Act.

COMMISSIONER MacKINNON: The difficulty with your small corporation thing is that it is small corporations that are guilty of some of the most numerous offenses and probably some of the most damaging bid rigging.

MR. ORLAND: I don't agree with that, Judge.

COMMISSIONER MacKINNON: All your contractors in America.

MR. ORLAND: I agree with that, but I think that that is more evidence of the prosecutorial priorities of the Antitrust Division for the past eight years than the prevalence of price-fixing in the United States, with respect, sir.

COMMISSIONER MacKINNON: I think that you will find that that actually is a indication of the offense as it exists.

You said that probation should be the choice for corporations. And on what conditions? Are you posing something equivalent to receiverships? Are you in that area?

MR. ORLAND: I like the conditions that Congress specified. I think that they work well.

COMMISSIONER MacKINNON: Do you think they work as well with corporations as they do with individuals?

MR. ORLAND: I think they can be made to work as well. I think that the copy draft proposals on probation conditions provide a fine point of departure for dotting i's and crossing t's as to what the probation conditions should be. In other words, you

have those laid out for you.

COMMISSIONER MacKINNON: If you wanted a probation and a fine, you would have to have two counts, wouldn't you?

MR. ORLAND: No. No, sir. You can impose a fine and an order of probation. They are not mutually exclusive, as I understand.

COMMISSIONER MacKINNON: Thank you.

CHAIRMAN WILKINS: Thank you very much. I hope that you will allow us to continue to call upon you in the near future.

MR. ORLAND: I will be pleased, sir.

CHAIRMAN WILKINS: Thank you.

(Witness excused)

CHAIRMAN WILKINS: Mr. Sheldon Elsen, of Orans Elsen & Lupert.

S H E L D O N H. E L S E N, called as a witness, stated as follows:

CHAIRMAN WILKINS: In addition to being a practicing attorney, Mr. Elsen is a adjunct professor of law at Columbia University.

I understand, Mr. Elsen, you have been there for some twenty years, is that correct?

MR. ELSEN: That's correct.

CHAIRMAN WILKINS: We are delighted to have you with us. Appreciate your taking the time from your practice and from your teaching responsibilities to assist us in this important endeavor.

MR. ELSEN: You compliment my staying powers for twenty years; I compliment yours for staying here for over two hours without a break. There was a time when I as a trial lawyer would normally hint as tactfully as I could to the judge that maybe it wouldn't be a bad time to take a break, but I see you haven't been taking any. I know it would be a lot easier for me to make the points that I think I have to discuss with you if I took a short break.

CHAIRMAN WILKINS: We don't take a break unless the court reporter gives me the high sign.

MR. ELSEN: OK. I knew I was going to lose that one, but in any event I am sure you will pay much more attention now by the fact that I have challenged it. But there we are.

I wanted to start also a little differently. I guess I am the only speaker today who has had substantial experience as a prosecutor. I spent some years as an Assistant United States Attorney in this

district, and in those days we had our offices in this building. I prosecuted white collar cases, I had a lot of experience in dealing with the types of problems we have been talking about today. For the same two decades since I left the U.S. Attorney's Office and have been teaching part time, I have also been defending a number of cases, including a number of white collar cases, some of which involved corporations. In my work at the law school, I have, among other things, taught criminal law, and I have been concerned with these problems through the Association of the Bar of the City of New York. I am now vice president and formerly headed its Federal Courts Committee, though I do not speak on their behalf because they work through a committee. That is the committee system. I am here, therefore, expressing my own view.

I wanted to start off by talking about one of the types of problems that have been coming up frequently today, and I think Judge Breyer has been the one who has raised a lot of these, and that is the talk about how we get to these losses. There has been a lot of talk, in dealing with the model that has been presented to us for review, about what the losses are in particular cases. In the course of many investigations,

including some very large ones, I couldn't tell you what the loss was in that case, because that was not our concern. When you get a case in, you don't know, first of all, whether it is a corporate or an individual case; that is obvious. And when you investigate it, your focus is on criminal intent, it is on moral factors. You are trying to determine whether the people you have under investigation are a bunch of crooks; whether they are a bunch of business people making rational decisions that went wrong. Nobody normally gets indicted when they make money. It is when the company gets into trouble that they go down. The big focus in these long investigations is usually on their moral capacity, what they did.

My last case in the United States Attorney's Office here was a case we got from the SEC that had been through several years of investigation there. It was also through a long investigation before a grand jury here. It took six months to try. If you asked me to tell the sentencing judge to even make a halfway rational estimate of what the loss to the public was in a case involving sales of unregistered stock and stock manipulation and blundering of companies and the like, I would be very hard put to have made even a halfway

rational determination. But I had the goods to convict, and we did convict.

You can tell the U.S. Attorney that in a corporate case they should divert their time and their resources. Perhaps you can create civil methods by which they can investigate matters further. I think Judge MacKinnon said earlier that when you get the criminal cases tried first, you don't really know what the civil loss is. That certainly corresponds to my experience. You can do it through the prosecutor. I would suggest that that is not the way to do it. You make poor use of scarce, very scarce resources that are better devoted to making other cases that are criminal in nature. The use of prosecutorial resources for finding out how much the social loss is is a very questionable matter, unless the Justice Department in its next budget has enormously increased.

Then also the question about going against closely held corporations and publicly held corporations: I think a little reflection will show what I think my experience has shown: that when you are dealing with a closely held corporation, you normally can find out who did it. It is a rare closely held corporation where you cannot find out the responsible

individuals. Also, the lines of responsibility are much more close.

I was involved in defending some of these foreign bribery charges for Fortune 500 companies, and it is absolutely true it is very hard sometimes to find the levels of responsibility. The head of the international division, does he know what is going on? Does the vice president know what is going on? Who winked at whom? These are hard questions. It is not normally true in a closely held corporation. So, as a result, the types of problems we have been struggling with today rarely arise in the closely held corporation; and when they do, that is a big company and we are dealing with problems more of the type that we are talking about, with publicly held corporations.

So I would say that, though you have the theoretical possibility of measuring the loss in terms of property loss, that on the social matter you are making a very questionable choice. As Professor Coffee, I think, quite rightly said, you will be taking prosecutors away from organizational prosecution if you force them into this huge use of their scarce prosecutorial resources to develop the remedy for the sentencing court. I think we should pause very

carefully before forcing that.

There are other problems with the draft on the fine, which other witnesses have adequately and very well expressed. The problems of other social harms, I agree with Professor Coffee, are in many cases very hard to quantify. What is the quantification for bribing a federal judge? How much does that harm? Well, it harms enormously. What is the quantification for destroying the vested confidence in the honest functionings of the stock exchanges upon which our capital raising in this country depends? Very hard. How do you tie it to the individual case? But if you take the price of attempting what I consider an illusory form of precision, if you try to be precise, you are going to leave those other harms out of your equation in this attempt at precision. I would suggest that is not a sound social judgment.

Similarly, the multiplier -- I think Professor First put it extremely well -- is very hard to consider as other than arbitrary. We have arbitrary standards. We have treble damages under RICO; we have treble damages under antitrust. But if you are talking about an arbitrary multiplier, let's call it an arbitrary multiplier and let's face it on those terms.

To say that it has to do with the risk of detection I do not think withstands careful thought.

One minor point, but I think of some significance to your draft, is that it attempts to factor in enforcement costs as part of the fine. I suggest that as the Justice Department is now constituted, you cannot measure enforcement costs.

First of all, consider the fact that an investigation does not start out as an investigation of an organization. It starts out as an investigation of a lot of facts, who did it, who is going to be involved. Sometimes you have bribery dry holes. How do you factor your dry-hole investigation into your enforcement cost? How many times do you chase Corporation Y when it should have been Corporation B. How do you allocate the coconspiratorial stuff? That is very hard. Then what do you do with the Justice Department's overhead and what do you do with the SEC's overhead or the Labor Department or whoever did the investigations?

You know, one of the great joys of being a government lawyer is that you don't have to keep time sheets. I see there is a representative from the Justice Department here. I can imagine what that would do within the Justice Department if you have to keep

time sheets when you have an organization under scrutiny but you don't have to for the rest of your time. That is, of course, not insuperable. But the problems of allocating overhead factors and the like are very difficult as the Justice Department is now constituted, and the question of whether you want to restructure it for purposes of going after these very important corporate cases is something you ought to think very hard about.

I think others have already suggested and Gerry Lynch talked about the measure of the number of cases involved, that the SEC cases are not an adequate measure, one reason being, of course, that the SEC has the most powerful apparatus for dealing with organizational offenders on the civil side. That is not true for a lot of other types of crimes. Environmental cases and heavy overseas bribery cases become prosecutions. Ex post facto the task force in Justice was looking for corporations all the time. And I think those would have been corporate cases had they come.

Having spoken a good bit about this question of the practical and the institutional allocation judgments that you have to make in determining to go after this type of fine system, let's take a look at the

other options, and that is where we get to the draft that is before you on the question of probation.

There are problems in applying what have been characterized as coercive remedial orders in this area. The problem takes on a different coloration if you view it as against the range of alternative options. Probation may look difficult under some circumstances, may look different under some circumstances, if it is viewed alone. But when you view it against the difficulties of applying fines, as we have talked about, then I think it becomes more attractive.

There is another interesting thing. We talk a lot about deterrence, and that certainly is a major function of the criminal law. The notion of rehabilitation is pretty heavily discredited when it comes to individual offenders, many of whom learn by incarceration in prison what it is like to be subjected to homosexual rape and don't necessarily come out with improved character. But when you have coercive devices that deal with offenders outside of the penitentiaries, and you have methods of dealing with it, which is what probation does, interestingly enough you may have rehabilitative functions for the malfunctioning corporation that you do not have for individual

corporations.

So, though I agree that deterrence should also be considered in that case, the idea that you can hope to get at the problem in the corporation and to reform it is no small advantage for our criminal justice system, because I think most people feel that the objective of the criminal justice system is to make this a safer society. And that is indeed where you are going.

I think Professor Coffee and his two colleagues, whose draft I studied earlier and upon which I had commented, have plunged head-on into the difficult problems that are involved in this area. And it is not by any means free of problems. I think one of the most difficult is that the Probation Department as presently constituted is totally inadequate for preparing reasonable corporate remedies. You cannot have an overworked probation officer who can't even figure out something on a small case give a presentence report to a judge that has any hope of being meaningful. The copy draft, however, faces up to that and says, look, if you are going to do this, you better get in a special probation officer with special skills, someone who knows finance, someone who knows corporate life and who can do

the job. And he would put the cost on the organizational defendant.

The analogy, of course, is to the SEC type of consent decree, when you bring in somebody to clean the act up. And the corporation has to pay for it. That is an interesting and a very controversial proposal. I am not suggesting that it should not be subject to be very careful thought and scrutiny. But it is important.

I am sorry, all this discussion about fines today has deflected our attention from what is really a very novel and very valuable approach to beefing up the Probation Department. I see Judge Breyer is nodding recognition of the problems of the probation officer. You have got to deal with that problem.

The second thing you have to deal with, in order to have justice in this area, you have got to provide for reasonable corporate input. The ABA Standards have talked about that. Let corporations be heard on what their views are of what is a reasonable remedy.

The copy draft suggests that the corporation should have such an input. I think that you should go all the way with what the ABA minimum standards suggest, and that you should have evidentiary hearings in the

occasional case where you are going to have corporate probation. It is going to take some judicial resources and some judicial time, not an awful lot, because it should not be a full-time trial. But you have to do some of that, and I think that also should be thought through. Because if you are not going to give due process to corporations, you are also creating a social blot. It should not only be effective but it should be fair.

The idea of internal investigations and special counsel to monitor and clean up, I think are very similar to the problem of creating special probation officers. You have to pay for these people, you have to have skilled people, and they have to be independent. I believe that any internal counsel who is retained by management isn't worth his salt. It has to be appointed by the court, it has to be paid for, it has to be a person of skill, but they have to report to the court and, ideally, also to an independent probation officer who is specially skilled, because you have to have people with financial experience.

Enforcement of violations. I think Judge Wilkins was concerned about that. I do agree with Professor Coffee's draft that Section 1509 provides that

individuals who interfere with enforcement can be subject to criminal contempt. It is a pretty serious crime. I have talked to corporate officers who faced consequences of criminal contempt. It is not laughed at. And when you have internal monitoring set up, the idea that that individual who is interfering with the enforcement of a judicial probation order will take it cavalierly and say they didn't get me the first time, they are not going to get me this time, is not realistic. They are going to be very cautious about interfering with that order.

I thank you very much for your attention. I see that my time isn't up yet, so I would like to take your questions.

CHAIRMAN WILKINS: We thank you for the time and effort that you put into your presentation.

MR. ELSEN: Thank you, sir.

CHAIRMAN WILKINS: Any questions?

COMMISSIONER BLOCK: I have one question, sir. Admittedly this IBM-calculated appropriate fine is difficult, and I have a clarifying question in terms of the substitution of this wonderfully novel administrative remedy. I am trying to get straight in my mind what I find is the description of, well, it is

really difficult to calculate anything approaching the correct fine, so, I don't know, we throw up our hands in that area and we say that we will substitute for that the threat of this administrative remedy which we will call probation. And then I gather the implication is that we don't necessarily need to know what that costs, we don't need to know too much about what that threat of probation will do; it is sufficient to be able to fix the situation after the violations occur. Is is the idea to let as many violations occur as well, because we can't know the right fine, and then after we capture these firms we will run these firms through the administrative remedy?

MR. ELSEN: Professor Block, I want to say that before we started today I wasn't sure, since you teach law or economics, whether you were a lawyer or not, and you told me during the break that you were an economist. But as I listen to you, Professor Block, I hear a very familiar note, and the only thing I find missing from a very skilled trial lawyer on the other side is, "I am just a country lawyer" (laughter) and "until you get it clear in my mind." That is very effective with jurors. But I do submit, with respect, sir, that you are comparing apples and oranges. My

criticism of the attempt to measure is a critique of the theory that you can use a cost benefit, a kind of a cost analysis, like a pricing mechanism in the world of economic theory, as a method of dealing with the problems. One of the reasons is that it can't be measured. There are problems in using probation; I most certainly believe that those problems must be thought through. What you are dealing with, and your job, if I may suggest, is to compare these two systems. One is illusory, and that is the thought that you are going to be raising the price and pegging the price with some precision to what the loss is. I just don't think you are going to accomplish your deterrence in that way. The other I think is not illusory but requires very careful thought. I think that is the difference.

COMMISSIONER BLOCK: I heard today that 14 percent of firms were convicted, 14 percent of the 100 largest firms have been convicted of federal violations of the law. If that is the case, aren't we headed towards a system, if we don't rely on fines at all, but rely only on supervisory probation, of having half, maybe three-quarters, of the largest firms in this country under court supervision?

MR. ELSEN: I very much appreciate your

saying that, so I can clarify. I am certainly not suggesting that you should not rely on fines at all. We are talking about a range of options. Most sentencing judges find that they like to use a variety of methods. So I do think you should rely on fines to some extent, and probation to some extent, yes.

COMMISSIONER BLOCK: But you say that it is hopeless, that the search for a deterrent-based fine system is hopeless. It is, in your words, a loser and why use it. Is it just a redistribution? Do we use it instead of a tax system?

MR. ELSEN: No, I am saying the search for a precise measure of fines is hopeless, it is illusory. But slap a million-dollar fine on a given probationer, that is OK, judges can do that kind of thing. The judge has to have a horseback sense that this fine is going to make this corporation sit up. That is a lot more precise than your attempt to measure it, if I may suggest, sir. I am not saying that you shouldn't take into account everything you can, everything that the U.S. Attorney can supply you with, everything that the special probation officer can supply you with. That should all be factored in. You should think about all those things. I am not suggesting that any reasonable

data should be ignored. I am just suggesting that you should not kid yourself that you have a degree of theoretical precision that you simply do not have.

COMMISSIONER BLOCK: Let me just go over it one more time and then I will relent. The concern is that fines are always going to be very imprecise. I guess I still fail to see the argument that if you grant the ability of fines to influence behavior, why we shouldn't use an iterative system?

MR. ELSEN: Why we shouldn't use a what?

COMMISSIONER BLOCK: An iterative system. We start with a guess about where the best beginning point is and then we observe the system and essentially make the system better all the time, make the fine system better all the time, with the objective that the fine is going to send signals for corporations to monitor their arrangements, their agents.

MR. ELSEN: Well, I mean you can do that. It is true that that has been true of individual offenders. You give a stiffer sentence. The first time you have an insider trading case you have a two-month sentence and you may have a six-month sentence or you may have a two-year sentence. I don't know whether you want to call it iterative or under the circumstances just jack

it up.

I am a trial lawyer, Professor Block, and I am used to talking in simple concepts that people can grasp. You can make tougher sentences and people might react. That is perfectly open to you. All I am suggesting is that you are not going to make precise relationships between the fine and the loss and hope to deal with the social ills that are there. You will pardon me for saying I am just a simple trial lawyer. You asked for that, OK.

COMMISSIONER BREYER: Let me hear your reaction to the other side of the coin, because the interesting idea, which I think is interesting, is the notion of probation where that is meant to say probation as a condition of doing the following things, and then there is a list. For example, Professor Coffee lists a compliance plan. If the court finds the management policies or practices encouraged or facilitated or otherwise substantially contributed to the criminal behavior or delayed its detection, the court should require the filing of a compliance plan, and then has a number of things: that it conduct a special audit, appoint independent counsel, adopt new information-gathering procedures, designate a special

compliance officer, etc.

This is overstating it, I am sure, but to get your reaction I will overstate it purposely. When I started out working in the Antitrust Division, after a while I met a person who had a small office and I asked someone what he did. I found out that what he did was to come periodically to Judge Palmieri's court, and Judge Palmieri and this man ran the motion picture business in the United States. Then there was another man in the United States who did approximately the same thing with respect to ASCAP. Then there was another one who ran the meat packing decree. The meat packing decree was a decree whereby basically a federal judge, helped by the Department of Justice, ran the meat packing industry. And I overstate only a little bit. Then there was another person who was running AT&T, except he wasn't as successful perhaps. (Laughter) But all these decrees, which were, after all, enforcement decrees that were entered in civil Antitrust Division litigation cases, gradually took on a life of their own. Even when I was there, it became hard to modify a decree, once entered, if anybody objects to it. And there might be competitors or customers or others who do object. Even in a criminal case there can be people

going through the department and suggesting what they ought to do. These things tend to take on a life of their own. I think in the meat packers case, at the time I was in the Division, the Division thought that became highly anticompetitive, interfering with the objectives it was supposed to secure.

I guess this leads me a little bit to go slow in this sort of area. Is there a risk in here, have we thought it through enough, has the ABA thought it through enough, that we are certain that that kind of risk, on the one hand, is worth running, or how do we safeguard against it when we are moving in that direction as compared to the very obvious problems we have when we rely solely on fines, which I agree with you about?

MR. ELSEN: Your point is very well taken. I think that when I reacted to the Coffee drafts I thought it was something that should be thought about. The first thing I would suggest is that you ought to make sure this doesn't turn into a device for patronage of people who are not qualified to do this type of thing, if that is what you are hinting at. It used to be in New York City that the big argument for having wills was that you didn't want somebody from Tammany Hall being

the guardian for your children. That is true. That has to be watched with some care. I don't know what happened in that area. Maybe you can say something about that particular type of problem.

Then the second thing is that, as the ABA Guidelines and as the copy draft also suggested, probation should not be jumped at in every case. There should be something of a history where it appears that there are internal problems which are subject to control. I would suggest in your thinking and in your work you should, if you, for example, have internal controls that have to be put into place, that maybe you ought to have methods of bringing those probation periods under time controls. They should not become a vehicle for somebody to run with that company for years and make a career of it. I couldn't agree with you more about that, Judge Breyer.

Another point is that there ought to be corporate input. That is why the corporation should be heard and there should be an appeal, if I may suggest. I think the copy draft suggested there should be an appeal if the decree is unreasonable in terms of the problem. That draft has to be the subject of maybe another whole hearing. This only came up just at the

end of the day. The problems that you are talking about are important and they are difficult and they really ought to be fleshed out.

CHAIRMAN WILKINS: Any other questions?

COMMISSIONER GAINER: For the record, the Department is no longer packing meat or packing theaters. It would be happy just to take the money.

COMMISSIONER MacKINNON: I would just say one thing. On your loss of investor confidence, I thought that they did a pretty good job at least in poking away at the investor loss in the insider trading case when they went back and dug out the computer transactions on stocks from a certain day on and compared them and came up with the dollar figure.

MR. ELSEN: You know, there are some cases where the loss is easier to measure than in others. Insider trading happens to be an area which is more readily quantifiable than many types of white collar offenses. I wasn't meaning to suggest that there was no type of white collar offense. Interestingly, insider trading is one that would rarely come into the criminal side for the setting of fines because of the fact that you have the Insider Trading Act and the SEC enforces that. But your usual case, Judge, as I am sure you

appreciate and probably agree, is much harder to quantify than that.

Also, another interesting thing about these insider trading cases and about the degree of difficulty of detection; in this city, after Dennis Levine was caught and after Boesky was caught, very large individuals were still involved in insider trading. This kind of thing goes on and on and on despite what happened. I am not quite sure why I made that point. It was in response to something that came up earlier.

COMMISSIONER MacKINNON: Thank you.

CHAIRMAN WILKINS: Thank you very much, Mr. Elsen.

MR. ELSEN: Thank you.

(Witness excused)

CHAIRMAN WILKINS: The next witness is Jonathan Baker, professor of economics at Dartmouth College.

J O N A T H A N B A K E R, called as a witness, stated as follows:

CHAIRMAN WILKINS: Professor Baker, we are pleased to have you with us.

Professor Baker has submitted written

testimony, but only one copy, which is fine, and I just want the Commissioners to know that it will be reproduced and supplied to the Commissioners and staff when we get back to Washington.

Professor Baker, we will be delighted to hear from you at this time.

MR. BAKER: Thank you, your Honor.

Good afternoon. I am an assistant professor at the Amos Tuck School of Business Administration at Dartmouth College. I am delighted to have the opportunity to meet with you today to share my enthusiasm for the discussion draft.

I believe that the Commission should adopt its approach to criminal sanctions, which is based on the economic theory of optimal penalties. I have a brief oral statement which will be supplemented by the written statement you have accepted into the record. I want to thank you all for staying in session late into the afternoon to hear me.

I have previously addressed the issue of organizational sanctions in the civil context, both as an economist and as a lawyer. My economic analysis of private damage remedies for antitrust violations is about to appear in a scholarly journal. In addition, I

have served as an attorney adviser to Acting Chairman and Commissioner Terry Calvani at the Federal Trade Commission. In that capacity, I participated extensively in internal discussions about how the FTC should exercise its authority to seek civil penalties and impose injunctive relief against organizations in certain consumer protection cases.

In my remarks today, I will explain why I believe that the economics-based analytic framework for determining organizational sanctions adopted by the discussion draft is the best approach for setting penalties. In doing so, I will emphasize the reasons why you should not be troubled by the notion of an efficient violation, and the reasons why monetary sanctions for organizational crimes will serve the purposes of criminal penalties.

I will also comment on two technical issues: the discussion draft's choice of victim loss as the penalty base rather than violator gain, and the size of multiples applied to that penalty base.

The primary strength of the discussion draft is that it incorporates the insights of the economic approach to determining optimal penalties. The promise of this approach is that it will lead potential

violators to make decisions -- and in the organizational context these are typically compliance program decisions -- that maximize social wealth.

Firms face a difficult tradeoff in allocating resources. They can invest time and expense in producing the goods and services they sell, or they can invest resources in setting up legal compliance programs, training employees in legal compliance, investigating the criminal record of new hires, and monitoring corporate activities at all levels for possible criminal violations.

If penalties are set at too high a level, the compliance effort will burden the productive activity. If penalties are set at too low a level, firms will not find it worthwhile to train employees in compliance.

The economic theory of optimal penalties describes a system of penalties which induces firms to choose the right level of compliance in order to maximize social wealth. In this context, social wealth may be thought of as the value of the productive activities of law-abiding firms net of the expenditures they make on legal compliance, and less the net harm to society of those violations that are not deterred by the threat of criminal sanctions. The discussion draft is

exciting because it seeks to impose precisely the wealth maximizing penalties suggested by this theory.

The economic approach to setting penalties is troubling to some because it accepts that some violators will continue to engage in criminal activities. Such violations are termed "efficient" in the economic literature on optimal penalties because they have benefits to the violator in excess of their social costs.

If this terminology somehow suggests that these violations will go unpunished, it is misleading. Under the optimal penalty scheme, all violators who are detected will be prosecuted, and all who are convicted must pay an appropriate multiple of the harm they cause others. Further, the discussion draft properly allocates such payments to victims as restitution, to the extent feasible. Thus, the fact that a violation may be efficient neither excuses it from penalty nor bars its victims from receiving compensation.

The economic approach to sanctions recognizes that a tradeoff between increased compliance expenditures, which are costly to society, and increased violations, which are also costly, is implicit in any scheme of sanctions.

As a society, we choose not to spend all our social resources in deterring crime. We recognize that some unlawful activity will occur as a consequence of this resource allocation decision, but that does not mean that we consider lawbreakers to be good actors in any sense who should go unpunished.

Further, the economic approach ensures that the social resources devoted to deterring lawbreaking go first to stop those crimes that are extremely harmful to victims without greatly benefiting violators, and to stop those crimes that are the cheapest to deter. Because the most socially costly crimes draw the biggest penalties under the economic approach, firms will emphasize deterring those violations in setting up their compliance programs. Although the crimes that remain undeterred do cause their victims some injury, the economic approach in principle ensures that the worst crimes are deterred the most.

The discussion draft relies primarily upon monetary sanctions for implementing the optimal scheme of criminal penalties for organizations. In general, fines and other monetary penalties are less costly for a court to enforce than organizational probation and cause less interference with productive corporate activities.

So the prospect of fines should be looked to in the first instance in preference to the prospect of probation as a way of inducing the appropriate level of internal firm compliance with the law.

But the discussion draft properly supplements monetary sanctions with a provision for probation when a firm exhibits a pattern of criminal activity in apparent disregard of the deterrence incentives created by the scheme of optimal penalties, or when a firm cannot immediately pay its full fine. Moreover, in such cases, deterrence can be increased even more strongly than organizational probation permits if prosecutors are able to indict and convict the individuals within the lawbreaking organizations who have taken part in crimes, so that courts can impose nonmonetary sanctions on those lawbreakers.

My final comments concern two technical issues in the computation of the optimal penalty. First, I agree with the discussion draft that the penalty should be based on the victim loss rather than the violator gain. This is the clear implication of the economic theory underlying optimal sanctions. The deterrence incentives facing potential lawbreakers are at their economically efficient level if every potential

violator is forced to take into account the harm his activity will cause others. A penalty based on victim loss accomplishes that result.

However, the choice of penalty base may matter less in practice than in theory. In particular, if violator gains are more readily calculated with the information available to a court than victim injury, the sentencing authority may find it necessary and sensible to use violator gains as an estimator of victim loss. Neither the victim loss nor the multiple need be determined with more than rough precision in order to achieve the full deterrence benefits of the economic approach, so long as the court employs a methodology that, on average, arrives at the correct values.

Second, were I drafting the organizational sanctions guidelines, I would alter the multiples applied to the penalty base to the extent permitted by the statutory limits on fines. Multiples are employed to increase the penalty in order to raise the costs to those violators who choose a covert method of criminal operation or are otherwise difficult to detect and convict. In my judgment, based on no more evidence than anyone else has, the discussion draft's multiples are likely too low for most covert crimes. For example, I

suspect that the probability of detecting and convicting a fly-by-night fraudulent operator engaged in door-to-door telephone sales is substantially lower than 1 chance in 3 1/2, the lowest probability of detection and conviction implicit in the draft proposal.

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 the penalty at a multiple of one. I believe that average enforcement expenditures per violation are largely invariant to both the number of violations prosecuted and the level of the resulting penalty. I would therefore view the resources devoted to enforcement as a fixed social cost associated with each successful prosecution and treat those costs as part of the penalty base.

I consider these suggestions for modifying the multiple as matters about which reasonable people can differ. Even when the discussion draft differs from my views, I believe that its approach is a plausible and defensible one.

In summary, I am enthusiastic about the discussion draft proposal for organizational sanctions. It applies a sensible analytic framework to rationalize

the system of organizational penalties. Because that 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.

If my remarks have raised any questions, I would be happy to answer them.

CHAIRMAN WILKINS: Thank you very much. To my right?

COMMISSIONER BLOCK: Professor Baker, I want to follow up on your description and background that you had in fact been at the FTC when there was some discussion of applying this penalty approach in a civil context. Do you have some experience in actually getting to the loss calculations in the fraud area that might be useful in terms of informing us as to the difficulties?

MR. BAKER: Well, I do have some experience in evaluating the estimates made by the Commission staff, and in reviewing the approaches that they adopted. In my experience, it was not always easy to arrive at the loss data or the gain data. Sometimes the

Commission sought to look at the gain to the violator rather than the loss to the victim. But it was always possible to get a reasonable ballpark guess.

These estimations were made in the context of the Commission deciding what civil penalties to seek in court. So it is a little different procedural circumstance from the situation facing a judge on sentencing. And the evaluations were made when the Commission was not able to take advantage of judicial discovery, which was in the investigation stage when the Commission was deciding what penalty it would settle for in consent negotiations and what penalties to seek in the complaint.

Nevertheless, with the limitations on available evidence that were forced upon it by the fact that it was early in the investigation that this discussion was taking place, the Commission was fairly well able to come up with a guess as to the size of the loss, in the sense that we could always tell apart a violation that caused a loss to victims of $10,000 from one that caused a loss to victims of $50,000, and tell that one apart from the one that caused a loss of $200,000.

I always thought that I could personally

look at the evidence and arrive at a reasonable figure, even though the various people who felt the same way in the Commission had a dispersion of values that they would come up with.

I also believe that the approaches that we used were, on average, correct. That is all that you need have happen for the general deterrence results that you want to derive from a system of penalties to occur. You don't have to always get it right in every case. You just have to use an approach to estimate the loss that, on average, gets it right. And then all prospective violators will see that, on average, the court system will choose the right penalty, and these potential violators will take that into account in making their decisions as to how to arrange their compliance burden.

CHAIRMAN WILKINS: Any questions to my left? Do you have any questions?

COMMISSIONER MacKINNON: How would you compute a loss for a corporation that paid a bribe to break a strike?

MR. BAKER: I don't know.

COMMISSIONER MacKINNON: I don't think we have dealt with that, have we? I have a concrete case

in mind. They paid a bribe to break a strike.

MR. BAKER: I guess we have to identify first who was injured here, who in society, and --

COMMISSIONER MacKINNON: Of course, that is problematic, isn't it? Actually they weren't successful. They were not successful in breaking the strike.

MR. BAKER: I guess you raise two issues in this question. One is the cost to the members of the labor union, I suppose, in impeding their productive activities, but that is the secondary issue. I think what you are raising is the question that I guess Professor Coffee had in mind earlier when he spoke about how do you measure your loss is from public corruption generally, that somehow there is an integrity loss that is costly to society. This gets into the area of loss is of life, which are very hard to quantify. And in fact some of these loss is, perhaps this is a case, are not even measurable on the same metric as dollars.

COMMISSIONER MacKINNON: Are they measurable at all? That is the point.

MR. BAKER: What we do --

COMMISSIONER MacKINNON: Shouldn't you really take a case like that and base the fine on the degree of

criminality that the judge feels is involved?

MR. BAKER: What you really should do in such a case is prosecute the agent and send him to jail, because then you can --

COMMISSIONER MacKINNON: We got all of them, don't worry about that.

MR. BAKER: Then you have applied a nonmonetary sanction which is also, perhaps, difficult to measure in terms of dollars, but of a very large magnitude, the deprivation of liberty, as an offset to a violation which you also feel is very difficult to monetize. The role of the court in such a case, when it also has the organization before it, should be to ask whether, on balance, looking at the sanctions that are going to be applied to these agents -- hopefully, the sentencing decision for the organization will come after the sentencing decision for the agents, so that my story will hang together -- that the court can decide that, all things considered, the level of the penalty is not commensurate with the level of the harm to others, the harm to the victims, and therefore an additional monetary sanction must be applied to the corporation; or else that the slap on the wrist, which I think you are pushing me to suggest, the computation of the loss for

some of these kind of cases, would be equivalent.

COMMISSIONER MacKINNON: I am not pushing you in any direction. I am just asking. We had the corporation, we had the international vice president, we had the three subordinate officers of the local union, and we had the executive vice president of the corporation. How would you come out with something on the corporation there?

MR. BAKER: And all of those --

COMMISSIONER MacKINNON: The individuals were all taken care of, prosecuted.

MR. BAKER: Sent to jail, whatever.

COMMISSIONER MacKINNON: Sent to jail, and this was the case that led the Teamsters Union to be ejected from the AFL some 35 years ago.

MR. BAKER: I am afraid I don't know. If you would like me to address it further in additional written comments, I would be happy to do so.

COMMISSIONER MacKINNON: I just use that as one example of the cases that have gone through my mind as we have heard this discussion about economics and computing of value for some of these types of offenses that have happened every day. It seems to me that they just don't provide a method for a great many penalties

that are incurred.

MR. BAKER: I agree that your case is much harder than the case of fraud or someone's not getting something he paid for, or some of those cases that I was dealing with at the Federal Trade Commission.

COMMISSIONER MacKINNON: Thank you.

CHAIRMAN WILKINS: Any other questions? Thank you very much, Professor Baker.

(Witness excused)

CHAIRMAN WILKINS: In keeping with the policy we established long ago, these hearings are open to the public, and anyone wishing to address the Commission is welcome to do so. So I ask, is there anyone in the courtroom who wishes to speak? Is there any matter of information anyone wishes to express?

Apparently not. In that case, this hearing will stand adjourned, and we will reconvene in Los Angeles.

Thank you very much.

- - -

NOTES/
HANDOUTS -

Counters
Dicker
Driesse
Scalia
Wroblewski

- In 1991 - 5 yr. study period - gls. for orgs.
- In one sense, even more groundbreaking than gls for individs.
  - whereas gls for individs. cd be constructed around ideas for which there was wide consensus. (using a gun is more serious, prior record) little consensus on corp. sentencing.
- In this sense the organizational gls. were strikingly new - They did have a core philosophy: organizations that had diligently sought to do the right thing in terms of law abidance (compliance, disclosure, coop.) ... vs. ...

- "Carrot and stick" philosophy, aside from seeking to bring about a fairer system of sentencing orgs., also created incentives for companies "to do the right thing" - ie. compliance, discl., coop.

- The guidelines appear to have had an impact:
  - newsletters, books, conferences
  - they are somewhat general: companies, the enforcement community are debating what companies must actually do.
  - USSC 1) is considerably asked to speak, 2) tel. calls re: cases, data

Distill what is going on

- Conference: (1) Practical info: of what companies, industries, and specialized groups are doing; empirical research; (2) how enforcement community views these new laws (3) Address new & emerging policy issues.