

University of Miami Law Review

Volume 66
Number 2 *Volume 66 Number 2 (Winter 2012)*
*SYMPOSIUM From the Board Room to the Court
Room: The Evolving Legal Status of Corporate
Crime*

Article 2

1-1-2012

The Failure Of The Organizational Sentencing Guidelines

Jennifer Arlen

Follow this and additional works at: <https://repository.law.miami.edu/umlr>



Part of the [Law Commons](#)

Recommended Citation

Jennifer Arlen, *The Failure Of The Organizational Sentencing Guidelines*, 66 U. Miami L. Rev. 321 (2012)
Available at: <https://repository.law.miami.edu/umlr/vol66/iss2/2>

This Article is brought to you for free and open access by the Journals at University of Miami School of Law Institutional Repository. It has been accepted for inclusion in University of Miami Law Review by an authorized editor of University of Miami School of Law Institutional Repository. For more information, please contact library@law.miami.edu.

ARTICLES

The Failure of the Organizational Sentencing Guidelines

JENNIFER ARLEN*

ABSTRACT	321
1. GOALS OF CORPORATE LIABILITY	329
A. <i>Corporate Deterrence</i>	330
B. <i>Using Liability to Induce Corporate Deterrence</i>	334
2. MITIGATION PROVISIONS FOR COMPLIANCE, SELF-REPORTING, AND COOPERATION	336
A. <i>Structuring Penalties to Encourage Detection, Reporting, and Cooperation</i>	337
B. <i>Deficiencies with Guidelines' Provisions Governing Mitigation</i>	340
1. STRUCTURE OF THE ORGANIZATIONAL GUIDELINES	341
2. MITIGATION PROVISIONS GOVERNING SELF-REPORTING AND COOPERATION	343
a. Restrictions on the Scope of Mitigation	343
b. Inadequate Amount of Mitigation	344
3. MITIGATION PROVISIONS GOVERNING EFFECTIVE COMPLIANCE PROGRAMS	351
3. DEPARTMENT OF JUSTICE APPROACH TO MITIGATION	358
4. CONCLUSION	361

ABSTRACT

To deter corporate crime, corporate sanctions must be structured to induce large corporations to help federal prosecutors detect and punish corporate crime. Specifically, firms must be encouraged to detect and report wrongdoing, and to cooperate with the government's effort to identify and sanction the individuals responsible for the crime. Firms will not engage in these activities unless they face lower expected sanctions if they detect, report, and cooperate than if they do not. This article examines whether the Organizational Sentencing Guidelines achieve this objective and shows that they do not. Although the Organizational Sentencing Guidelines offer sanction mitigation to firms that adopt

© 2011, Jennifer Arlen.

* Norma Z. Paige Professor of Law, New York University School of Law. I would like to thank Miriam Baer, Brandon Garrett, John Moot, and participants at the Conference on Corporate Crime at the University of Miami School of Law for helpful comments and discussions. I also want to thank my research assistants, Tristan Favro and Kristy Fields. I also benefited from the financial support of the Filomen D'Agostino and Max E. Greenberg Research Fund of the New York University School of Law.

effective compliance programs, self-report, and cooperate, this article shows that these provisions offer too little mitigation to encourage firms to detect, report, and cooperate. Indeed, the Guidelines' mitigation provisions are particularly inadequate in the very circumstances where corporate detection and investigation is most important: in cases involving crimes committed by managers of large firms. As a result, U.S. efforts to deter corporate crime are undermined by adherence to the Organizational Sentencing Guidelines. This may partly explain why the Department of Justice adopted an alternative strategy for encouraging corporate reporting and cooperation, one that differs materially from the Organizational Guidelines. To help deter corporate crime, the Sentencing Commission should reform the Guidelines.

Both the strength of the U.S. economy and the well-being of our citizens depend, in part, on our ability to deter corporate crime, especially by large corporations. Yet the government cannot effectively deter corporate crime by large firms on its own. Federal authorities need to induce firms to help them detect and sanction wrongdoers.

Federal authorities cannot deter crime effectively unless they can ensure that employees (including managers) who commit crimes face expected penalties that exceed the benefit they get from committing the crime. This simple goal is not easy to achieve, however, because wrongdoing often is not detected and individual wrongdoers often escape sanction. Thus, in order to effectively deter corporate crime, the government needs to ensure that it can reliably and cost-effectively detect wrongdoing and identify and sanction the individuals within the firm who are ultimately responsible for the crime.¹ In the case of large firms, the government often cannot cost-effectively detect wrongdoing on its own. The most effective way to detect wrongdoing and identify and sanction wrongdoers is to induce corporations to detect and report crimes by their employees and help the government obtain the evidence it needs to identify and convict the individuals responsible. Firms can do this by adopting compliance programs *ex ante* that detect crime, and by intervening *ex post* to investigate and report suspected wrongs and fully cooperate with the government's effort to identify and sanction the individual

1. See Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833 (1994). The government would not need to invest in detection if it could feasibly impose unlimited sanctions on individuals. In the real world, the government cannot impose unlimited sanctions. Thus, to optimally deter crime it must increase the expected sanction by increasing the probability that wrongdoing is detected and sanctioned. *E.g.*, Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence*, in RESEARCH HANDBOOK ON CRIMINAL LAW (Keith Hylton & Alon Harel eds.) (forthcoming 2012) (on file with author) (discussing why optimal deterrence requires expenditures on enforcement, which in turn implies that optimal deterrence generally requires corporate expenditures on detection, investigation, and cooperation).

responsible for the crime. These measures, hereinafter referred to as “corporate policing,” help deter crime by increasing the probability that individual wrongdoers are criminally sanctioned if they violate the law. Accordingly, in order to deter corporate crime, the government needs to induce firms to adopt effective compliance programs, self-report wrongdoing, and fully cooperate with enforcement authorities to bring individual wrongdoers to justice.²

Corporate liability, both criminal and civil, remains the most effective way to achieve these goals. But corporate liability is only effective if it is structured to ensure that firms are better off when they undertake effective measures to detect wrongdoing and help the government convict wrongdoers than when they do not.³ Corporate criminal liability thus cannot serve its central purpose unless it is structured to provide firms with strong incentives to detect and self-report violations, as well as to cooperate with governmental authorities’ efforts to sanction individual wrongdoers. Indeed, corporate sanctions undermine the central purpose of corporate liability when firms face higher expected sanctions when they engage in optimal corporate policing than when they do not.⁴

In the United States, criminal liability of firms convicted of most federal crimes is in effect governed by the U.S. Sentencing Guidelines Governing Organizations.⁵ The United States Sentencing Commission adopted the Organizational Guidelines with the clear purpose of deterring corporate crime.⁶ The Commission was particularly concerned

2. *See id.*

3. *See* Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 699 (1997) (concluding that corporate liability should be designed to induce firms to adopt prevention and policing measures, where corporate policing includes compliance programs designed to detect wrongdoing, corporate reporting of wrongdoing, and corporate cooperation with prosecutors); Arlen, *Corporate Criminal Liability*, *supra* note 1, at manuscript at 58; *see also* Melissa Ku & Lee Pepper, *Corporate Criminal Liability*, 45 AM. CRIM. L. REV. 275, 289 (2008). The conclusion that corporate penalties must be designed to induce firms to prevent, detect, and self-report wrongdoing, cooperate with authorities, and, where possible, remediate the harm caused, applies equally to civil and criminal enforcement. Arlen & Kraakman, *supra*; Arlen, *Corporate Criminal Liability*, *supra* note 1.

4. *See* Arlen & Kraakman, *supra* note 3; *see also* Arlen, *Potentially Perverse Effects*, *supra* note 1.

5. U.S. SENTENCING GUIDELINES MANUAL ch. 8 (2010) [hereinafter ORGANIZATIONAL GUIDELINES]. In 2005, the Guidelines became advisory, and not mandatory. *See United States v. Booker*, 543 U.S. 220, 245 (2005) (rendering the individual guidelines advisory). Nevertheless, the Guidelines can be expected to significantly influence corporate criminal sanctions even though they are now advisory. *See* Cindy R. Alexander, Jennifer Arlen & Mark A. Cohen, *Regulating Corporate Criminal Sanctions: Federal Guidelines and the Sentencing of Public Firms*, 42 J. L. & ECON. 393, 414–17 (1999) (finding that following the adoption of the Organizational Guidelines judges imposed higher total sanctions (criminal, civil, and administrative) on publicly-held firms than they did previously, even in cases where they were not required to apply the Organizational Guidelines).

6. One of the primary purposes of the Guidelines was to reform Organizational Sentencing

about wrongdoing by employees of large firms. Towards that end it adopted Guidelines designed to substantially increase the criminal fines imposed on large firms.⁷ It also structured criminal fines in a way that it hoped would encourage corporations to adopt effective compliance programs, self-report detected crimes, and fully cooperate with the government's efforts to investigate and sanction wrongdoing.⁸

The Sentencing Commission recognized that government authorities could not induce effective corporate policing if it retained the traditional approach to corporate liability.⁹ Under the traditional rule of respondeat superior, firms are strictly liable for employee crimes committed in the scope of employment, even if the firm tried to prevent, eventually detected, and reported the wrong. Moreover, firms engaging in effective corporate policing could not be sure that their efforts would entitle them to a substantial reduction in the fine.¹⁰ This traditional approach had perverse effects. It tended to discourage firms from intervening aggressively to help the government detect and sanction corporate crimes because corporate efforts to help the government could hurt the firm by increasing its probability of being held criminally liable.¹¹ In order to induce corporate policing, federal authorities needed to adopt a "duty-based composite regime," under which firms are held liable for their employees crimes, but the amount of liability would be substan-

practice to better deter corporate crime. Congress reaffirmed that deterrence is a central goal of organizational sanctions when it instructed the Sentencing Commission to review and amend the Sentencing Guidelines to ensure that the provisions that apply to organizations "are sufficient to deter . . . organizational criminal conduct." Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 805(a)(5), 116 Stat. 745, 802. Deterrence was not the only goal. Additional goals include the need to provide restitution to victims and "just punishment." U.S. SENTENCING COMMISSION, SUPPLEMENTARY REPORT ON SENTENCING GUIDELINES FOR ORGANIZATIONS 5 (1991), available at http://www.ussc.gov/Guidelines/Organizational_Guidelines/Historical_Development/OrgGL83091.pdf. In addition, the Organizational Guidelines also were originally intended to restrain judicial discretion. The Guidelines promoted this goal by requiring judges to impose fines falling within the range provided by the Guidelines, except in specific circumstances. See *supra* note 5 (noting that the Guidelines are now advisory but still influential).

7. See Alexander, Arlen & Cohen, *supra* note 5, at 414–17 (providing evidence that the Organizational Guidelines achieved their goal of increasing the criminal fines imposed on large firms by showing that the criminal fines imposed on publicly-held firms were higher in cases where judges were constrained to apply the Organizational Guidelines than in post-Guidelines where the Organizational Guidelines were only advisory).

8. Fines also were structured to serve other aims. See *supra* text accompanying note 6 (discussing the multiple goals of the Guidelines). But one important goal of fine mitigation is—and should be—to encourage firms to engage in effective corporate policing. This is evident from the Guidelines provisions that specify the desired structure of an "effective" corporate compliance program, as well as the mitigation provisions that reward firms that adopt an effective compliance program, self-report, and cooperate. See ORGANIZATIONAL GUIDELINES, introductory cmt.

9. See ORGANIZATIONAL GUIDELINES, introductory cmt.

10. See generally Arlen, *Corporate Criminal Liability*, *supra* note 1, at 4–5 (discussing the traditional rules governing corporate criminal liability).

11. See Arlen, *Potentially Perverse Effects*, *supra* note 1, at 842–43.

tially reduced (and perhaps shifted from criminal to civil) if the firm satisfied any (or each) of its policing duties: specifically adopting an effective compliance program, self-reporting detected wrongs, and fully cooperating with federal investigations.¹²

To encourage corporate policing, the Sentencing Commission adopted Organizational Guidelines that formally embraced a form of “duty-based” composite corporate criminal liability, under which corporations that satisfy a set of policing duties face a lower criminal sanction than those that did not. The Organizational Sentencing Guidelines provide that firms are entitled to a reduction in their corporate criminal fine if: (i) the firm had an effective compliance program and promptly reported any detected wrongdoing; (ii) the firm self-reported the wrong, fully cooperated and accepted responsibility; or (iii) the firm fully cooperated and accepted responsibility.¹³

This Article shows that the Sentencing Commission failed to adopt an effective regime.¹⁴ To deter wrongdoing, criminal penalties must be structured to ensure that firms face a lower *expected* corporate penalty¹⁵ if they adopt an effective compliance program, self-report, or fully cooperate than if they do not, even though corporate policing increases the probability that the firm will be sanctioned for any crimes its employees commit. This article shows that the Organizational Guidelines do not provide firms with sufficient mitigation to ensure that firms face lower expected sanctions if they undertake effective corporate policing when corporate policing substantially increases the probability that the government can detect and sanction the wrong.¹⁶ Moreover, the perverse effects of the Guidelines are greatest in the very circumstances where effective sanction mitigation is most needed: specifically, large firms with wrongs that implicate managers. These crimes can be particularly difficult for the government to detect and sanction without corporate monitoring, self-reporting, or cooperation. Yet, perversely, the Guidelines offer the least percentage mitigation for policing to large firms con-

12. Arlen & Kraakman, *supra* note 3, at 753 (detailing an optimal duty-based corporate liability regime); *see also* Arlen, *Potentially Perverse Effects*, *supra* note 1 (finding that duty-based corporate liability can eliminate the perverse effects of respondeat superior).

13. ORGANIZATIONAL GUIDELINES § 8C2.5(f)–(g).

14. This article expands on a relatively brief analysis of this issue provided by Arlen & Kraakman, *supra* note 3, at 745–49.

15. The expected criminal sanction is the criminal sanction multiplied by the probability that the government detects the violation and sanctions the firm.

16. To further compound matters, corporations cannot be sure of what the sanction would have been absent policing or what it will be with policing because judges have discretion as to whether to apply the Guidelines. *See United States v. Booker*, 543 U.S. 220, 245 (2005). Moreover, even if they do apply the Guidelines, judges have considerable discretion concerning what fine to impose within the Guidelines fine range.

victed of crimes involving managers and to firms with a past history of wrongdoing. Thus, rather than helping to deter crime, the Guidelines discourage firms from monitoring, self-reporting, and cooperating by imposing greater expected costs on firms that monitor, self-report, and cooperate than on those that do not. The problems with the Guidelines are sufficiently serious that their application threatens to undermine the central purpose of federal corporate criminal enforcement.

The conclusion that the Organizational Guidelines do not provide firms with adequate incentives to adopt effective compliance programs, self-report, and fully cooperate is supported by evidence that the duration of corporate crimes by publicly-held firms stayed the same after the adoption of the Guidelines as before.¹⁷ This is consistent with the hypothesis that the Guidelines had little effect on detection and reporting.

Beyond this, it is worth noting that the Department of Justice (DOJ) no longer relies primarily on the incentives provided by the Organizational Guidelines to induce corporate policing. Approximately eight years after the adoption of the Organizational Guidelines, the DOJ formally adopted a policy designed to provide firms with far greater incentives to engage in effective policing than is offered by the Guidelines. Specifically, in 1999, then-Deputy Attorney General Eric Holder issued a memorandum to prosecutors detailing the factors they should consider when deciding whether to indict a corporation for its employees' crimes.¹⁸ These guidelines encouraged prosecutors not to prosecute firms that engage in specified good corporate conduct, even when firms could be held criminally liable through respondeat superior and would have been fined under the Organizational Guidelines. Following the Holder Memo, prosecutors increasingly have chosen not to prosecute firms if the crime occurred despite effective corporate policing, especially if the firm reported the crime and cooperated.¹⁹ Firms exempt

17. Alexander, Arlen & Cohen, *supra* note 5, at 407–08.

18. Memorandum from Eric Holder, Deputy Attorney Gen., U.S. Dep't of Justice, to Component Heads and U.S. Attorneys (June 6, 1999), available at http://federalevidence.com/pdf/Corp_Prosec/Holder_Memo_6_16_99.pdf [hereinafter Holder Memo]; see also Memorandum from Larry D. Thompson, Deputy Attorney Gen., to Heads of Dep't Components & U.S. Attorneys (Jan. 20, 2003), available at http://www.justice.gov/dag/ctff/corporate_guidelines.htm; U.S. DEP'T OF JUSTICE, U.S. ATTORNEYS' MANUAL § 9-28.800, available at http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrfm.htm#9-28.800.

19. The Sentencing Commission's data provides evidence to support the conclusion that most firms that self-report avoid formal conviction, and thus avoid sentencing under the Organizational Guidelines, at least for financial crimes and others involving fraud. This support comes from evidence that only one firm convicted each year self-reported the wrong on average (according to the Commission's data). Arlen, *Corporate Criminal Liability*, *supra* note 1, at 13 (Table Six). But see Brandon L. Garrett, *Globalized Corporate Prosecutions*, 97 VA. L. REV. (forthcoming 2011) (manuscript at 22, 41) (on file with author) (finding both that many convicted firms are not

from criminal prosecution still are subject to penalties (including remediation and forfeiture), which often are imposed through Deferred or Non-Prosecution Agreements (DPA or NPA, respectively). Yet the magnitude of mitigation produced by the decision not to convict (in concert with the monetary penalty reduction) is enormous. The DOJ policy favoring non-prosecution of firms that undertake effective policing (especially cooperation) provides stronger incentive for firms to adopt effective compliance programs, self-report, and fully cooperate than is produced by the Organizational Sentencing Guidelines.²⁰ Moreover, an increasing number of federal prosecutors are addressing compliance failures through a combination of smaller penalties, direct mandates, and monitoring, as opposed to relying primarily on the threat of substantial sanctions for non-compliance.²¹ The DOJ's non-prosecution policy provides some evidence that federal enforcement officials have decided that

included in the Commission's data; some convicted firms fully cooperated and some appear to have self-reported). By contrast, each year, many firms avoid conviction but are subject to non-prosecution agreements (NPA) and deferred prosecution agreements (DPA). Almost all of these firms fully cooperated and many self-reported the wrong. Thus, through this leniency program, combined with the DPAs and NPAs, the DOJ has created an alternative sanctioning regime to govern firms that engage in good corporate conduct. The DOJ appears to believe that this alternative regime is more effective at inducing compliance, self-reporting, and cooperation than the Organizational Guidelines.

For a discussion of the content of the DOJ's DPAs and NPAs, *see, e.g.*, Jennifer Arlen & Marcel Kahan, Corporate Governance Regulation Through Non-Prosecution (April 5, 2011) (unpublished manuscript) (on file with author); Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 888-99 (2007); Peter Spivack & Sujit Raman, *Regulating the 'New Regulators': Current Trends in Deferred Prosecution Agreements*, 45 AM. CRIM. L. REV. 159, 160-61 (2008); *see also* Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?*, 105 MICH. L. REV. 1713 (2007). For a discussion of the evolution of the role of publicly-held firms in criminal cases, *see* Harry First, *Branch Office of the Prosecutor: The New Role of the Corporation in Business Crime Prosecutions*, 89 N.C. L. REV. 23, 32-58 (2010); *see also* Samuel W. Buell, *Criminal Procedure Within the Firm*, 59 STAN. L. REV. 1613 (2007). For a discussion of evidence that some firms are convicted even though they self-report (and more are convicted than the Commission reports), *see infra* note 21; Garrett, *Globalized Corporate Prosecutions*, *supra*, at 41. For a discussion of problems with the Sentencing Commission's data on corporate crimes, *see* Cindy R. Alexander, Jennifer Arlen & Mark A. Cohen, *Evaluating Trends in Corporate Sentencing: How Reliable are the U.S. Sentencing Commission's Data?*, 13 FED. SENT'G REP. 108 (2000); Garrett, *Globalized Corporate Prosecutions*, *supra*, at 22.

20. In the case of certain crimes, firms want to avoid conviction, independent of the fine, because the collateral consequences to them of conviction for certain crimes are enormous. *See generally* Arlen, *Corporate Criminal Liability*, *supra* note 1 (discussing the collateral consequences of conviction); Assaf Hamdami & Alon Klement, *Corporate Crime and Deterrence*, 61 STAN. L. REV. 271, 279 (2008) (same).

21. For a discussion of prosecutors' increased willingness to use DPAs and NPAs to impose mandated compliance programs, corporate monitors, and other structural reforms on firms that otherwise will be eligible for conviction, *see, e.g.*, Jennifer Arlen, *Removing Prosecutors from the Boardroom: Deterring Crime Without Prosecutor Interference in Corporate Governance*, in PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 76-81 (Anthony S. Barkow & Rachel E. Barkow eds., 2011); Arlen & Kahan, *supra* note 19;

they need to provide stronger incentives to induce corporate policing than those provided by the Guidelines.

Nevertheless, the Organizational Guidelines—and their defects—are still important because the Guidelines continue to determine the sanctions imposed on many firms even when the firm engaged in some effective policing. This is because many U.S. Attorneys continue to convict firms even when the firm had an effective compliance program, fully cooperated, or undertook other policing measures.²² These convicted firms generally in effect remain under the Guidelines.²³ Thus, many firms still reasonably look to the Organizational Guidelines in determining whether to monitor, self-report, or cooperate. The problems with the Guidelines identified in this article thus continue to undermine efforts to induce firms to intervene aggressively to detect and report crime and to help convict individual wrongdoers.²⁴ Thus, to effectively

Garrett, *Structural Reform Prosecution*, *supra* note 19; Khanna & Dickinson, *supra* note 19; Spivack & Raman, *supra* note 19.

22. Arlen, *Corporate Criminal Liability*, *supra* note 1, at 11–12 (providing evidence that some firms are convicted even though they self-reported or had an effective compliance program); *see also* Garrett, *Globalized Corporate Prosecutions*, *supra* note 19 (finding that foreign and domestic firms often are convicted even when they fully cooperated). Firms that face criminal liability for antitrust, Foreign Corrupt Practices Act (FCPA), and environmental violations appear to be particularly vulnerable to conviction despite full cooperation. In the case of antitrust (e.g., cartels) and FCPA, there is some evidence that federal prosecutors tend to reserve leniency for firms that self-report and generally only grant leniency to the first firm in the cartel (antitrust) or industry (FCPA) to self-report. *Id.* at 33. Thus, the remaining firms can expect to have their sanctions governed by the Organizational Guidelines (or, in the case of Antitrust, the Antitrust Guidelines), when they decide whether to cooperate. It appears that the environmental division also almost never makes use of DPAs and NPAs and tends to convict firms even when they self-report (although they grant sanction mitigation). For a discussion of how government actors' preference for retributive, rather than deterrence-based, responses to corporate crime may explain why some federal prosecutors under-utilize leniency as a reward for self-reporting and cooperation, *see* Miriam H. Baer, *Choosing Punishment* (unpublished manuscript) (on file with author).

23. Technically, the Organizational Sentencing Guidelines govern the sanctions imposed on corporations for most corporate crimes, whether the firm is convicted following a trial or a plea agreement (although prosecutors can adjust pleas to adjust the sanction as well). The Guidelines do not govern all crimes, however. For example, antitrust violations are governed by a separate set of Guidelines. Alexander, Arlen & Cohen, *supra* note 5, at 397. In addition, the fine provisions of the Organizational Guidelines do not apply to most environmental, wildlife, food, drug, safety, or export control violations, although the Guidelines do apply if the crime also involves conduct covered by the Guidelines. *Id.*; *see also* RICHARD S. GRUNER, *CORPORATE CRIME AND SENTENCING* 436 (1994).

24. Indeed, even the U.S. Sentencing Commission eventually realized that its original mitigation provisions governing firms that adopt an effective compliance program were too restrictive. Under the original Organizational Guidelines, firms were in effect ineligible for fine mitigation for adopting an effective compliance program if the crime involved high-level personnel. In 2010, the Sentencing Commission amended the Organizational Guidelines to eliminate the prohibition on granting penalty mitigation to firms that have an effective compliance program if the violation involved any high-level personnel. *See* ORGANIZATIONAL GUIDELINES § 8C2.5(f)(3)(C). The Sentencing Commission's new mitigation provision permits penalty

deter corporate crime, the Sentencing Commission must reform the Organizational Guidelines to provide firms with stronger incentives to help federal authorities deter corporate crime.

This article proceeds as follows: Section One shows why government authorities cannot hope to effectively deter corporate crime by larger firms unless firms undertake effective corporate policing. It also explains why the state needs to employ optimal duty-based liability to induce optimal corporate policing. Section Two shows that the Organizational Guidelines' mitigation provisions fail to provide many firms with adequate incentives to adopt an effective compliance program. The Guidelines also provide inadequate incentives for firms to self-report wrongdoing or cooperate in many circumstances. Finally, Section Two shows that the problems with the Guidelines are greatest where corporate policing appears to be most needed: when corporate crime is hard to detect because the crime is committed by those in authority. Section Three discusses the change in DOJ enforcement practice which provides far greater incentive to undertake effective policing measures than the Guidelines. Section Four concludes.

1. GOALS OF CORPORATE LIABILITY

A primary purpose, if not the primary purpose, of liability for corporate crimes is to deter corporate crime in a way that maximizes social welfare. This goal should inform both individual and corporate liability for crimes committed by employees acting in the scope of employment, ostensibly on behalf of the firm. It should extend to both criminal and civil liability.

As this section shows, corporate liability deters crime in different ways than individual liability. As a result of these differences, corporate liability often must be structured differently than individual liability. Pure individual liability falls directly on the people who cause corporate crimes. It directly deters crime by directly increasing wrongdoers'

mitigation for an effective compliance program even if the crime involved high-level personnel, provided that the individuals in the firm with operational responsibility for the compliance program report directly to the board of directors (or similar governing body), the firm detects and reports the wrong, and no individual with operational responsibility for compliance participated in, condoned, or was willfully ignorant of the offense. *Id.* While the Sentencing Commission has improved its guidelines through this amendment, the Organizational Guidelines have additional problems identified in this article. Moreover, even the amendment is not an adequate solution to the mitigation issue because it only grants mitigation for a compliance program in cases involving high-level personnel if the firm actually detects the wrong. This limitation appears aimed at the increased risk that a firm's compliance program will not be truly effective when high-level personnel commit crimes. This concern would be better addressed in another way than a blanket limitation on credit for compliance program adoption for these crimes unless the firm detects (and reports) the wrong.

expected costs of committing crimes.²⁵ By contrast, corporate liability falls on those who own the company, and not directly on individual wrongdoers. In some cases, this distinction is not important, such as when crimes are committed (or condoned) by the firm's controlling shareholders (who also directly manage the firm). In this situation, corporate liability operates to deter wrongdoing largely in the same way as individual liability—by imposing a cost directly on the individuals responsible for the crime.²⁶ In many other situations, however, corporate shareholders are not involved in either the day-to-day management or the firm's criminal activities. In this situation, corporate liability does not fall directly on those responsible for the crime. Thus, the question is, why should firms ever be liable when corporate shareholders do not directly manage the firm and did not (and could not) commit the crime?

Corporate liability is important in this context because firms are uniquely positioned to deter their employees from committing crimes. First, firms directly affect—and indeed often determine—the degree to which their employees benefit from most corporate crimes. In addition, they can increase their employees' expected cost of crime. They can do this directly through *ex ante* actions that make crimes harder to commit as well as through *ex post* sanctions.²⁷ They also can increase their employees' expected sanctions through actions that increase the probability that the government detects crime and sanctions wrongdoers (corporate policing). Corporate liability should be structured to ensure that firms want to intervene optimally to detect and investigate suspicious activities, as well as to self-report crimes and fully cooperate with government efforts to bring individual wrongdoers to justice.²⁸

This Section examines the ways in which firms can deter corporate crime, focusing on crimes by larger firms (specifically, those that do not have a controlling shareholder involved in the day-to-day management of the firm who is complicit in the crime). This Section then explains the implications of this analysis for corporate liability.

A. Corporate Deterrence

The optimal corporate response to the possibility of a legal violation depends on the nature of the violation. Legal violations can be use-

25. Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968).

26. Arlen, *Corporate Criminal Liability*, *supra* note 1, at 18–19.

27. Arlen & Kraakman, *supra* note 3, at 706. Firms also can lower the expected benefit to employees of crime by changing their compensation structure. See Arlen, *Corporate Criminal Liability*, *supra* note 1, at 26.

28. See Arlen & Kraakman, *supra* note 3, at 691.

fully divided into two categories.²⁹ The first category is intentional wrongs: wrongs that corporate employees commit for their own benefit with knowledge that they are violating the law. Intentional wrongs include genuine fraud and certain forms of market manipulation, such as where a manager knowingly manipulates the market in an effort to boost profits in his unit, and thereby preserve his job or obtain a promotion or bonus. In the case of intentional wrongdoing, the government must ensure that individuals do not expect to benefit from violating the law. To do this, federal authorities must impose sanctions directly on the individuals responsible for such violations.³⁰ Federal authorities often cannot reliably ensure that wrongdoers are punished unless they can induce firms to intervene to deter, detect, or report wrongdoers.

Corporations can deter intentional wrongdoing in a variety of ways. First, corporations can deter intentional wrongdoing by reducing employees' incentives to violate the law. Employees generally prefer not to violate the law, but sometimes will if they face strong pressure to do so.³¹ Often employees intentionally violate the law in an effort to either save their jobs or earn a financial reward, such as when the wrong appears to be the only way the firm will gain the sales, profits, or increased stock price needed to preserve the employee's job or justify a promotion or raise. Corporations can reduce their employees' incentives to commit this type of wrong by ensuring that employees' tenure and salary do not depend on short-run performance measures, such as quarterly profits, revenues, sales or stock price, and takes into account compliance. Firms also can deter intentional violations by creating a corporate culture that promotes legal compliance. An effective culture of compliance can help deter violations both by imposing direct psychological costs on the person committing it and by making it harder to obtain the complicity of others needed to commit or conceal many corporate violations.

Beyond this, corporations can deter intentional wrongdoing by increasing the expected cost to potential wrongdoers of individual liability for any crimes they commit. Corporations can increase the expected cost to potential wrongdoers of threatened civil or criminal penalties by

29. See Arlen, *Corporate Criminal Liability*, *supra* note 1, at 14.

30. Arlen, *Potentially Perverse Effects*, *supra* note 1, at 834–35.

31. For evidence that corporate crimes generally are committed by managers for personal benefit, see, e.g., Cindy R. Alexander & Mark A. Cohen, *New Evidence on the Origins of Corporate Crime*, 17 *MANAGERIAL & DECISION ECON.* 421, 423 (1996); Cindy R. Alexander & Mark A. Cohen, *Why Do Corporations Become Criminals? Ownership, Hidden Actions, and Crime as an Agency Cost*, 5 *J. CORP. FIN.* 1 (1999); see also Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 *U. ILL. L. REV.* 691, 703 (1992) (providing theory and evidence that managers commit securities fraud for personal benefit).

increasing the likelihood that individuals who violate the law are sanctioned. Corporations can increase the probability of sanction in a variety of ways: (1) monitoring to detect wrongdoing;³² (2) investigating suspicious activities; (3) reporting violations to federal authorities; and (4) cooperating with authorities to help them identify and sanction the individuals responsible for the violation. Measures that increase the probability that the government can sanction the violation are referred to as "policing measures."³³

The second category of violations is unintentional. This category includes laws that the firm can violate even when its employees invest optimally in effort to prevent the violation.³⁴ Employees normally do not directly benefit from violating these laws. They generally will comply if they know the legal requirements and they do not bear the direct costs of compliance (or have adequate incentives to comply in any event). In such situations, as with intentional crimes, firms can deter crime by investing in prevention, detection, and post-violation policing.³⁵ In this case, the firm can help prevent crime through measures (such as compliance programs) that ensure that employees know the law, reduce the direct cost to employees of compliance, and promote a culture of compliance. Corporations also can deter unintentional crimes through policing measures that increase the threat presented by government sanctions. As with intentional crimes, these measures include monitoring programs, self-reporting, and cooperation with government efforts to bring individual wrongdoers to justice. These activities can deter unintentional violations in two ways. First, employees generally will respond to the increased threat of sanctions by exerting more effort to comply with the law. Second, policing measures designed to deter wrongs can reduce the social cost of any ongoing wrongs that do occur, such as environmental violations, by enabling the state to detect, stop, and intervene to correct violations more quickly than they otherwise would be able to.

Accordingly, we see that whether crime is intentional or unintentional, corporate policing is essential to optimal deterrence of corporate crime. Government authorities generally cannot deter corporate crime effectively unless firms engage in optimal policing because corporations

32. See Arlen, *Potentially Perverse Effects*, *supra* note 1, at 842.

33. See Arlen & Kraakman, *supra* note 3, at 699.

34. An employee invests optimally in effort to comply with the law when he invests up to the point where the additional cost of the last unit of effort just equals the resulting benefit, where the benefit is the impact of effort on the probability the violation occurs, multiplied by the social cost of the violation. See generally Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1 (1980) (defining optimal care). In those situations where the cost of a violation is truly enormous, and the cost to the firm of avoiding any risk of a violation is not prohibitive, optimal effort may absolutely deter any risk of a violation.

35. Arlen & Kraakman, *supra* note 3, at 691.

often are the lowest-cost providers of many forms of policing. This is particularly true when the firm is large. Firms can more cost effectively monitor *ex ante* to detect violations because they know their internal operations better than the state does, and thus have better information about the types of crime their employees might commit and where the evidence of such crimes would manifest. Corporate monitoring for crime also is more cost-effective than monitoring by the state because firms already collect (or should collect) much of the information needed to detect wrongs in the ordinary course of business.³⁶

Firms also can deter crimes by undertaking effective policing *ex post*, after the crime occurs. *Ex post* policing includes investigating suspicious activities, self-reporting any detected wrongs to government authorities, and fully cooperating with the government's efforts to identify the individuals responsible for the crime and obtain the evidence needed to convict them. Corporate policing is important because corporations are better able to detect most types of crimes than the government because they know how their operations should run when done legally.³⁷ They also generally can investigate wrongdoing at a lower cost than the government because they know from which employees to obtain evidence. They also have immediate access to their own internal documents and employees. Thus, the government can dramatically reduce the cost and improve the accuracy of criminal investigations by inducing firms to conduct genuine and thorough investigations and share their findings with the government. The need to induce corporate policing is particularly great in the case of larger firms with complex internal structures.³⁸

Finally, firms can deter crime by adopting prevention measures. Prevention measures do not increase the probability of detection. Instead, they either reduce the direct benefit to the employees of crime or make the crime more difficult or costly to commit. Corporate prevention is particularly important in the case of firms where ownership is separated from day-to-day control. This is because the firm directly determines the incentives that its managers and other employees have to

36. *Id.*; Arlen, *Corporate Criminal Liability*, *supra* note 1, at 28.

37. Firms are particularly likely to be the lower cost detectors of crimes when the crime does not produce an obvious harm and the boundary between legitimate activities and the wrong depends on the employee's intent. Fraud is just such a crime. Corporate detection is less important for crimes, such as massive oil spills, that are open and obvious, especially if intent is either obvious or is not needed to establish the crime.

38. Arlen & Kraakman, *supra* note 3, at 747; Arlen, *Corporate Criminal Liability*, *supra* note 1, at 30. For a discussion of the problems and challenges with this approach, see Miriam Hechler Baer, *Cooperation's Cost*, 88 WASH. U. L. REV. 903 (2011); Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. REV. 311 (2007); see also Brandon L. Garrett, *Corporate Confessions*, 30 CARDOZO L. REV. 917 (2008).

commit corporate crimes because non-owner employees generally do not directly benefit from corporate crime, but instead benefit indirectly as a result of corporate promotion and compensation policies. Corporate crimes generally directly impact the firm, and not individual employees. Employees are motivated to commit the crime by the hope that they will benefit personally through actions, such as crime, that increase the firm's profits, sales, or reported earnings. This benefit generally takes the form of increased compensation or increased job security awarded to those who help the firm increase short-run profits. When firms tie employee rewards to short-run performance, employees may benefit from committing crimes that benefit the firm in the short-run, even when the long-run impact on the firm is negative. Firms can help deter these crimes by restructuring their compensation and promotion policies to focus employee compensation and retention decisions on the firm's long-run returns, not short-term outcomes.³⁹

B. *Using Liability to Induce Corporate Deterrence*

Accordingly, in order to optimally deter crime by corporations—especially by larger firms—federal authorities generally need to induce firms to engage in optimal (1) prevention; (2) ex ante policing (monitoring); and (3) ex post policing (investigation, self-reporting, and full cooperation). All of these measures are expensive, however. Corporate boards of directors are obligated to ensure that the firm undertakes those measures only to the extent that they benefit the firm by maximizing long-run profits (or are mandated by law, which most are not). This implies that the government cannot expect firms to invest adequately in prevention, detection, and post-violation policing unless the firm's expected profits are higher (and thus expected costs are lower) when the firm undertakes optimal prevention, monitoring, and ex post policing than when it does not. This imposes two requirements on corporate liability. First, when the direct cost of the crime falls on third parties not shareholders,⁴⁰ the government must impose liability on firms to ensure that they have a direct financial incentive to adopt optimal prevention measures. In addition, federal authorities must structure liability to ensure that firms are better off investing optimally in (1) ex ante policing (detection); and (2) post-violation policing (self-reporting and cooperation) than they are if they do not.⁴¹

39. Arlen & Kraakman, *supra* note 3, at 704; Arlen, *Corporate Criminal Liability*, *supra* note 1, at 27.

40. For a discussion of optimal corporate liability for one of the only crimes where publicly-held firm shareholders bear the cost of crime, securities fraud, see Arlen & Carney, *supra* note 31; Arlen, *Corporate Criminal Liability*, *supra* note 1, at 55–56.

41. Arlen & Kraakman, *supra* note 3, at 707; see also Arlen, *Corporate Criminal Liability*,

Federal authorities face a challenge in attempting to induce optimal prevention and policing because the corporate liability rule needed to induce optimal prevention will not induce optimal policing, and vice versa. As a result, federal authorities need to employ a composite rule that combines strict corporate liability for all employee crimes that harm third parties (as needed to induce optimal prevention) with duty-based liability designed to induce optimal policing.

Prevention measures simply deter wrongdoing—thereby reducing the likelihood that a firm will be hit with a civil sanction. Thus, a firm subject to sanctions necessarily reduces its expected penalty costs when it adopts prevention measures. When firms operate in competitive markets, with prices that adjust freely to reflect actual product costs, federal authorities can use the threat of corporate liability to induce firms to invest optimally in prevention. Federal authorities can achieve this goal by using respondeat superior to hold firms strictly liable for all employee crimes committed in the scope of employment to benefit the firm. This liability will induce optimal prevention so long as the firm's expected liability equals the full social cost of the crime (that the firm does not otherwise bear). This liability can be civil.⁴²

By contrast, federal authorities cannot use strict respondeat superior liability to induce firms to adopt optimal policing measures, such as monitoring to detect wrongdoing, self-reporting, and cooperation. Policing measures have two potentially competing effects on a firm. On the one hand, these measures benefit the firm by deterring wrongdoing because corporate policing increases the expected cost to individual violators by increasing the probability that the violation is detected and sanctioned. This deterrent effect of policing confers a benefit on firms that is positively related to the firm's expected liability if the violation occurs. On the other hand, policing measures are potentially costly for the firm. The cost of these measures goes beyond the direct costs of implementing them, and includes any increase in the firm's expected liability as a result of adopting policing measures. Policing measures

supra note 1, at 31 (explaining why the government cannot use individual liability to provide firms with optimal incentives to undertake prevention and policing); *id.* at 51 (explaining why firms will not police optimally even when they are subject to an expected market sanction for detected wrongdoing equal to the social cost of the crime).

42. Arlen & Kraakman, *supra* note 3, at 727; see Arlen, *Corporate Criminal Liability*, *supra* note 1, at 13–24 (discussing how and when the optimal sanction must be adjusted to reflect the fact that government and corporate enforcement is a social cost of crime). Cf. Michael K. Block, *Optimal Penalties, Criminal Law and the Control of Corporate Behavior*, 71 B.U. L. REV. 395, 397 (1991) (determining the optimal sanction when government enforcement is costly); A. Mitchell Polinsky & Steven Shavell, *The Optimal Use of Fines and Imprisonment*, 24 J. PUB. ECON. 89 (1984) (determining the optimal sanction for purely individual crimes when government enforcement is costly).

have the potential to increase the firm's expected liability costs because policing increases the likelihood that federal authorities can detect a wrong and obtain the evidence needed to bring a successful action for the violation. To the extent the actions are brought against individual violators, policing simply produces a deterrent effect. But to the extent federal authorities also sanction the firm, then the firm's investment in detection, self-reporting, and cooperation may increase the firm's own expected liability.⁴³ This liability enhancement effect has the potential to undermine (or eliminate) firms' incentives to detect, self-report, and monitor. Accordingly, to induce firms to optimally monitor, self-report, and cooperate, federal authorities need to structure the penalty regime to ensure that firms always face lower expected costs when they invest optimally in detection, self-reporting, and cooperation, than when they fail to do so.⁴⁴

The next section discusses how federal authorities should structure penalties to achieve these aims and explains why the Organizational Guidelines do not achieve these goals. Section Three discusses changes to the Guidelines that would better enable the Guidelines to induce firms to intervene to deter corporate crime, which are consistent with the enforcement policy adopted by the Department of Justice.

2. MITIGATION PROVISIONS FOR COMPLIANCE, SELF-REPORTING, AND COOPERATION

This section assesses the mitigation provisions of the Organizational Guidelines to determine whether they are structured to achieve the central goal of corporate liability, which is to deter corporate crime. As previously explained, as applied to crimes involving larger firms, corporate criminal sanctions will not deter corporate crime effectively unless they induce corporate policing: specifically, monitoring, self-reporting, and cooperation. Accordingly, this section focuses on whether the Organizational Guidelines employ a penalty structure that encourages corporate policing. As explained in this section, in order to induce corporate policing the state must employ a duty-based corporate liability regime, under which a firm faces a much smaller sanction (or even no criminal

43. See Arlen, *Corporate Criminal Liability*, *supra* note 1, at 42 n.89; Arlen & Kraakman, *supra* note 3, at 708. Although little empirical analysis exists on the degree to which corporate policing increases a firm's probability of being criminally sanctioned, a recent empirical analysis of firms' self-reporting of restatements to the Securities and Exchange Commission finds that self-reporting significantly increases the probability that the firm is sanctioned. Rebecca Files, *SEC Enforcement: Does Forthright Disclosure and Cooperation Really Matter?*, J. ACCT. & ECON. (forthcoming 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1640064.

44. Arlen, *Potentially Perverse Effects*, *supra* note 1, at 849; Arlen & Kraakman, *supra* note 3, at 692-93.

sanction) if it engages in optimal monitoring, self-reporting, or cooperation.⁴⁵ This section shows that, consistent with optimal deterrence, the Organizational Guidelines provide that convicted firms should be subject to a lower criminal fine if the firm adopted an effective compliance program, self-reported the wrong, or cooperated, in some circumstances. Nevertheless, the Organizational Guidelines are ineffective because the amount of mitigation is insufficient to truly encourage corporate policing, especially when the firm is large or corporate policing is particularly effective.⁴⁶

A. Structuring Penalties to Encourage Detection, Reporting, and Cooperation

The most effective way to induce corporations to take the actions that government authorities want them to take is to structure sanctions to ensure that firms that take the desired actions are better off than those which do not. This implies that the government must structure corporate civil and criminal liability to ensure that firms that detect, report, and cooperate face lower expected costs than those who do not. Thus, the Guidelines must ensure that each firm that implements an effective program to detect wrongdoing, or reports, or cooperates, gets the benefit of a reduction in its *expected* liability that equals or exceeds the expected cost to the firm of compliance, reporting, or cooperation, respectively.⁴⁷ Given that policing imposes direct costs on the firm, we know that the government cannot induce effective policing unless the firm's total expected penalties—if it engages in optimal policing—are lower than if it does not. This presents a challenge for corporate liability because policing increases the probability that the firm is sanctioned for any and all crimes that are not deterred. Accordingly, in order to ensure that firms benefit from policing, the government generally must *substantially* reduce the actual penalty imposed on firms for those crimes that are detected if the firm policed optimally.

This implies that the Guidelines cannot reliably induce corporate

45. Arlen, *Potentially Perverse Effects*, *supra* note 1, at 866–67; Arlen & Kraakman, *supra* note 3, at 710.

46. The deficiencies in the Organizational Guidelines may result, in part, from the fact that the Sentencing Commission did not fully embrace a deterrence-oriented approach to corporate crime—even with respect to publicly-held firms (whose shareholders are not complicit in the crime)—but instead formally embraced many goals. This undermined the Guidelines' effectiveness at achieving one of the most important goals of corporate criminal liability—detering corporate crime.

47. A firm's expected liability costs equal the number of violations expected when the firm has a compliance program, multiplied by both the probability that the government detects and sanctions the violation (when the firm has a compliance program) and the sanction imposed when there is a compliance program.

policing unless they grant sufficient mitigation to counteract the fact that policing increases the probability the firm is sanctioned. Thus, in order to ensure that a firm's total *expected* liability—as given by the probability of sanction multiplied by the penalty—is lower if it engages in optimal policing than if it does not, the Organizational Guidelines often must ensure sufficient penalty mitigation to counteract the increase in the probability of detection produced by corporate policing.⁴⁸

To illustrate, consider the case of reporting and cooperation. A firm that reports detected wrongdoing and cooperates with the government's investigation generally guarantees that federal enforcement authorities will be able to sanction it for violations that otherwise might have gone undetected and unsanctioned. In other words, the firm often increases its probability of being sanctioned from $P < 1$ to $P_{report} = 1$. Accordingly, in order to encourage reporting and cooperation, the Sentencing Commission must structure penalties so that the penalty imposed on the firm if it does report and cooperate is lower than the *expected* penalty imposed on a firm that does not report and cooperate—where the expected penalty imposed for failure to report is the actual penalty multiplied by the probability that the government can detect and sanction the wrong if the firm does not self-report and cooperate (PF). When reporting and cooperation significantly improve the enforcement staff's effectiveness, the amount of mitigation must at least counteract the increase in the probability of sanction produced by the firm's policing activities.⁴⁹

To see this, consider a firm that has detected a violation and must decide whether to report and cooperate. Assume that if the firm does not report and cooperate, the government may not ever learn of the crime. By contrast, if it reports and cooperates, the government definitely will be able to sanction the firm for the violation. Specifically, assume that if the firm does not report and cooperate, the probability is only 20% that the government can detect and sanction the firm on its own.⁵⁰ If the firm does report and cooperate, the government certainly can sanction the

48. The precise condition depends on the deterrent effect of corporate policing, which provides an additional benefit to firms that police effectively. Where the deterrent effect is uncertain, federal authorities cannot reliably induce corporate policing unless they structure liability to eliminate the liability enhancement effect of corporate policing. See Arlen & Kraakman, *supra* note 3, at 721–23 (discussing optimal duty-based mitigation); Arlen, *Corporate Criminal Liability*, *supra* note 1, at 31–36 (same); see also Arlen, *Potentially Perverse Effects*, *supra* note 1, at 842–43 (showing that duty-based corporate liability can be used to induce optimal corporate monitoring); John S. Moot, *Compliance Programs, Penalty Mitigation, and the FERC*, 29 ENERGY L.J. 547, 569 (2008) (arguing that firms that satisfy all three policing duties should receive “significant” mitigation of the penalty imposed for serious violations).

49. Arlen & Kraakman, *supra* note 3, at 750–51.

50. There is limited empirical evidence on the probability that wrongs are detected, but the limited evidence available suggests that the government does not detect many crimes on its own. Alexander Dyck, Adair Morse & Luigi Zingales, *Who Blows the Whistle on Corporate Fraud?*, 65

firm. In this situation, a firm that reports and cooperates faces an expected sanction equal to the mitigated penalty:

$$\text{Penalty}_{\text{Mitigated}}$$

By contrast, a firm that does not report faces a low probability (20%) of having to pay higher unmitigated sanction. This results in an expected penalty of .20 multiplied by $\text{Penalty}_{\text{Unmitigated}}$:

$$.2(\text{Penalty}_{\text{Unmitigated}})$$

In order to create an incentive to report, the Guidelines must ensure that the expected (i.e., probability-adjusted) penalty imposed on firms that report and cooperate is less than the expected (probability-adjusted) penalty imposed on firms that do not. In this example, the Guidelines must ensure that the mitigated penalty is less than or equal to one-fifth of the unmitigated penalty:

$$\text{Penalty}_{\text{Mitigated}} < .2(\text{Penalty}_{\text{Unmitigated}})$$

If the amount of penalty mitigation is less than this, the firm is better off if it does not report or cooperate.

Similar analysis can be used to show that the Guidelines cannot be relied on to encourage compliance unless the degree of penalty mitigation accorded to firms that adopt effective compliance programs is sufficiently great to ensure that firms are better off adopting effective compliance programs. This implies that the amount of mitigation should reflect the increase in the probability of detection that results when a firm adopts an effective compliance program.⁵¹

J. FIN. 2213, 2251 (2010). Moreover, even if the government does detect the crime, it often needs corporate assistance to obtain the evidence needed to convict individual wrongdoers.

51. The precise conditions for optimal mitigation can be found in Arlen, *Corporate Criminal Liability*, *supra* note 1, at 59, and Arlen & Kraakman, *supra* note 3, at 755. Optimal mitigation for compliance program adoption differs from optimal mitigation for self-reporting because firms adopting an effective compliance program not only suffer a liability enhancement penalty but also may derive a deterrence benefit at the moment they make the investment decision (assuming the program reduces the expected number of violations). Nevertheless, if firms cannot quantify the deterrence benefit, and thus are likely to discount it in determining the costs and benefits of compliance, then mitigation will not reliably encourage effective compliance unless mitigation fully counteracts the increase in the probability of sanction resulting from the firm's adoption of an effective compliance program.

Mitigation for compliance programs also raises special problems because it is difficult to determine whether a firm with detected wrongdoing nevertheless had a genuinely effective compliance program (and commitment to on-going compliance monitoring) or merely cosmetic compliance. See generally Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L. REV. 487 (2003). Prosecutors and judges must make sure not to grant credit for purely cosmetic compliance. Moreover, additional concerns arise that, even with adequate credit, publicly-held firms may not adopt effective compliance programs because of agency costs. Arlen & Kahan, *supra* note 19. Agency costs may result in firms failing to adopt truly effective compliance programs even when the government provides optimal incentives. Agency costs may be particularly strong with respect to compliance because shareholders cannot easily monitor whether managers are actively overseeing compliance. For this reason, in some

B. *Deficiencies with Guidelines' Provisions Governing Mitigation*

The Sentencing Commission recognized the central importance of corporate policing in structuring the Organizational Guidelines. The Organizational Guidelines thus provide that firms that adopt effective compliance programs, self-report, and cooperate should face a lower criminal fine than those that did not engage in optimal policing, under some circumstances. Nevertheless, the Sentencing Commission failed to achieve the core deterrence goal of corporate liability—inducing firms to detect, self-report, and cooperate—because the Commission adopted mitigation provisions that are too narrow in scope and too small in magnitude to genuinely encourage effective efforts to detect wrongdoing, self-report it, or fully cooperate. The deficiencies are particularly great for the provisions governing the fines imposed on large firms for wrongs by higher level or multiple supervisory personnel. The adverse consequences of this failure have been significant: in many circumstances, the Guidelines discourage firms from adopting effective compliance programs, self-reporting, and cooperating by imposing higher expected penalties on those that do.⁵² While the DOJ has reduced the problem in some circumstances through its corporate non-prosecution policy (discussed below), the perverse incentives that the Guidelines create still operate for firms that are not confident of getting the benefit of this DOJ policy.

This part details the deficiencies with the Guidelines' provisions governing mitigation for firms that adopt compliance programs, self-report, and cooperate. The Guidelines are plagued with two problems. First, they excessively restrict the circumstances under which firms are eligible for mitigation. Second, firms—especially large firms—that are eligible for mitigation obtain too little mitigation to encourage active efforts to detect, report, and cooperate.

circumstances it may be optimal to supplement duty-based sanctions with mandates requiring the firm to adopt an effective compliance program. It also may be optimal to supplement this mandate with a mandate requiring the firm to accept a corporate monitor. *Id.* For a discussion of problems with the existing DOJ approach to prosecutor-imposed structural reforms, *see, e.g., id.*; Arlen, *supra* note 21; Garrett, *Structural Reform Prosecution*, *supra* note 19; Khanna & Dickinson, *supra* note 19.

52. Arlen & Kraakman, *supra* note 3, at 745–49 (showing that the Sentencing Guidelines will not induce firms to invest in detection, self-reporting, and to cooperate). The degree to which corporate criminal liability with inadequate mitigation reduces firms' incentives to police depends in large part on the effect of corporate policing on firms' probability of detection and sanction. Firms threatened with liability (with inadequate mitigation) may be deterred from corporate policing unless the government will be able to detect and sanction any crimes their employees commit even if the firm does not engage in effective policing.

1. STRUCTURE OF THE ORGANIZATIONAL GUIDELINES

In order to assess the effectiveness of the Guidelines' mitigation provisions, we must first set forth the factors that determine the corporate criminal fine under the Guidelines.⁵³ The Organizational Guidelines provide that the judge should impose a criminal fine on the firm that falls within the "minimum of the guideline fine range" and the "maximum of the guidelines fine range," except in exceptional situations. The minimum and maximum fines are determined by multiplying the "base fine" associated with the offense by the minimum and maximum fine "multipliers," respectively.⁵⁴

The Organizational Guidelines provide that the base fine is the greatest of (1) an amount set forth in the Offense Level Table; (2) the pecuniary gain to the firm from the crime; or (3) the pecuniary loss from the offense, to the extent that the loss was caused intentionally, knowingly, or recklessly (by the employee committing the offense).⁵⁵ This base fine is then multiplied by the minimum and maximum multipliers to determine the fine range.

The minimum and maximum multipliers are obtained by calculating the firm's "culpability score." The culpability score is based on a set of factors that go beyond corporate culpability in the sense of corporate shareholder culpability. Instead, culpability is based largely on whether senior management is complicit in the crime or alternatively is attempting to deter corporate wrongdoing by undertaking effective corporate policing. Specifically, in determining the culpability score, each firm starts with five points. Points are then added to the culpability score if crime was committed or condoned by anyone within the high-level personnel of the firm or a unit of the firm (if the unit is large), or if tolerance of the offense by substantial authority personnel was pervasive throughout the firm or unit. The number of points added in this situation ranges from one to five depending on the size of the firm. Firms with 5,000 employees or more have five points added to their culpability score in this situation.⁵⁶ Points also are added if the firm has a prior history of the offense, violated an order in committing the offense, or

53. This section only discusses the provisions governing the criminal fines. In addition to criminal fines, the Guidelines also impose other penalties on firms convicted of corporate crimes, including disgorgement (criminal restitution), remedial orders, and corporate probation. The corporate probation can include nonmonetary sanctions, such as a requirement to adopt an effective compliance program. ORGANIZATIONAL GUIDELINES, ch. 8; *see also* Arlen, *Corporate Criminal Liability*, *supra* note 1, at 6–8 (discussing the structure of the Guidelines and providing evidence on the magnitude of corporate criminal fines and total criminal sanctions).

54. ORGANIZATIONAL GUIDELINES § 8C2.7.

55. *Id.* at § 8C2.4.

56. *Id.* § 8C2.5(a)–(b).

obstructed justice.⁵⁷

It is worth noting that for most important crimes, firms with more than 200 employees can expect to start with a culpability score of at least eight. This is because firms with 200 or more employees have three to five points added to the base score of five if high-level personnel committed the crime or tolerance of the crime by supervisory personnel was pervasive⁵⁸ and high-level personnel is broadly defined. It includes anyone who sets “policy” for or “controls” either the firm or the unit affected by the crime (if the unit had 200 or more employees). Supervisory personnel is defined even more broadly. When one considers crimes such as securities fraud, health care fraud, and money laundering, most of these crimes require (or involve) the participation of someone with a considerable degree of authority who can speak for the firm. Thus, many important crimes are likely to trigger the culpability score enhancements that push the unmitigated culpability score over eight.

Firms can obtain a reduction in their culpability score if they adopt an effective compliance program, self-report detected wrongdoing promptly, fully cooperate with the government’s investigation, and/or accept responsibility, at least in some circumstances. A firm that satisfies all of the policing duties imposed by the Guidelines can obtain an eight point reduction in its culpability score. Thus, a large firm (5,000 or more employees) that starts with a culpability score of ten as a result of managerial complicity in the crime can use policing to get its culpability score reduced to two. A firm that starts with a culpability score of five ends up with an effective score of zero. Firms that adopted an effective compliance program prior to the violation being detected can get a three-point reduction in the culpability score, provided that they satisfy the other requirements needed to obtain mitigation for monitoring. Firms that self-report promptly, fully cooperate, and accept responsibility are eligible for a five point reduction, if they satisfy the other requirements for mitigation. Firms that only fully cooperate and accept responsibility get a two point reduction in the culpability score.⁵⁹

The culpability score is important because it determines the minimum and maximum fine multiplier (which is multiplied by the base fine to determine the range of fines to be imposed on the firm). Firms with a culpability score of 10 or more are subject to a fine that is two to four times their base fine (and then other sanctions may be imposed as well). Firms with a culpability score of five are subject to a minimum multiplier of one and a maximum multiplier of two. Firms with a culpability

57. *Id.* § 8C2.5(c)–(e).

58. *Id.* § 8C2.5(b)(3).

59. *Id.* § 8C2.5(b), (f)–(g).

score of zero or less are subject to a minimum multiplier of .05 and a maximum multiplier of .2, implying that, under the Guidelines, each firm faces a criminal fine even if it faithfully satisfies every policing duty.⁶⁰

There is no doubt that the Organizational Guidelines would help deter crime if the mitigation provisions provided sufficient fine mitigation to induce firms to police optimally. The problem is that the Guidelines adopted by the Sentencing Commission fail to provide adequate incentives to self-report, cooperate, or adopt an effective compliance program. To show this, we consider each of these in turn. We begin with self-reporting and cooperation because the government can best achieve its primary goal—imposing optimal sanctions on the individuals responsible for the crime—if it is able to induce firms (and particularly large firms) to self-report detected wrongdoing and cooperate with the government’s enforcement efforts.

2. MITIGATION PROVISIONS GOVERNING SELF-REPORTING AND COOPERATION

The Sentencing Commission made three mistakes in structuring the provisions governing fine mitigation for reporting and cooperation. First, the Commission excessively restricted the scope of mitigation by attaching too many conditions on the firm’s right to obtain mitigation. Second, the Commission did not grant a sufficient amount of mitigation to induce firms to self-report and cooperate. The problem is particularly pronounced in the case of *ex post* cooperation, which generally is vitally important to the government. Finally, the Commission incorrectly structured the Guidelines so that larger firms obtain a lower percentage reduction in their expected fine (all else equal) than small ones, even though the government is more likely to benefit from mitigation when the firm is large (and in turn, the firm is more likely to increase its own expected probability of sanction if it is large than if it is small) because cooperation by large firms is often more valuable.

a. Restrictions on the Scope of Mitigation

Consider first the Guidelines’ provisions governing mitigation for self-reporting. Firms are entitled to five points of mitigation for self-reporting a crime to the government but only if several conditions are met. The most important restriction for our purposes is the requirement that the firm “accept[] responsibility for its criminal conduct” in order to obtain mitigation for self-reporting.⁶¹ This condition is counter-

60. *Id.* § 8C2.6.

61. *Id.* § 8C2.5(g). In addition, the firm must self-report prior to imminent threat of disclosure

productive because firms cannot be confident that they will be deemed to have accepted responsibility unless they plead guilty.⁶² Given this, the Guidelines do not provide strong incentives for firms to report detected suspicious activities unless the firm is prepared to plead guilty. The firm might well not want to plead guilty for legitimate reasons, such as where the firm believes that its activities did not violate the law. While the Guidelines provide that a firm may get credit in such circumstances, the commentary states that this is a rare circumstance, which correctly leaves firms concerned that they will not be able to obtain credit for self-reporting should the firm decide to fight the criminal charges.

b. Inadequate Amount of Mitigation

Moreover, and more importantly, the amount of mitigation provided to firms that self-report, cooperate, and accept responsibility is too small to induce firms to undertake these activities, especially when they are most valuable. Moreover, the problem of inadequate mitigation is most pronounced for large firms.

A firm that self-reports wrongdoing prior to the imminent threat of disclosure, fully cooperates, and accepts responsibility often can expect to dramatically increase the probability that the wrong is detected and that the firm is sanctioned. Indeed, in the case of wrongs that can remain hidden indefinitely (which includes most frauds), it is likely that corporate self-reporting of previously undetected wrongs more than triples the probability that the government detects the wrong and sanctions the firm.⁶³ Moreover, in order to get credit for self-reporting, firms generally need to guarantee their own conviction by fully cooperating and accepting responsibility. Thus, the activities the firm needs to do to get credit for self-reporting often combine to *guarantee* that the firm will be penalized for violations that otherwise likely would have remained undetected and/or unsanctioned.⁶⁴

Accordingly, in order to ensure that firms want to self-report, fully cooperate, and settle, the Organizational Guidelines must ensure that the firm's expected (probability-adjusted) liability is lower if the firm engages in these activities than if it does not. This implies that a firm

or government investigation. The firm must have reported within a "reasonably prompt time" after becoming aware of the offense (which includes time to conduct an internal investigation). *Id.*

62. *Id.* § 8C2.5 cmt. 14.

63. Indeed, in the case of financial wrongs, including frauds, this likely is a generous assessment, because the government appears to detect far less than one-third of the crimes committed. Indeed, if senior executives and middle managers of publicly-held firms were to face a probability of detection of 33%, it is likely that few would commit corporate crimes, given that they generally could lead very comfortable lives without doing so.

64. See Arlen & Kraakman, *supra* note 3, at 708–09.

that self-reports and fully cooperates must receive sufficient mitigation to fully counteract the effect of these activities on the probability of sanction.⁶⁵ In other words, it must be the case that:

$$\text{Fine}_{\text{Mitigated}} < P(\text{Fine}_{\text{Unmitigated}})$$

where P is the probability that the government can detect and sanction the crime if the firm does not self-report and cooperate. In the case of a firm that detects a wrong that the government is unlikely to detect (say only 1/3 likely to detect), this implies that the mitigated fine cannot exceed 1/3 of the unmitigated fine, or else the firm is better off keeping quiet and hoping that the government does not detect the crime. Thus, reporting and cooperation must reduce the fine by more than 65%.

If we examine the amount of mitigation granted for these activities under the Guidelines, we see that it often fails to provide sufficient mitigation to self-report and fully cooperate in any situation where these activities confer a material benefit on the enforcement staff. In particular, many firms only get a fine reduction of 10–50%, leaving firms bearing 50–90% of the unmitigated fine even if they reported and cooperated (Table One). This is not sufficient to induce self-reporting when self-reporting more than doubles the government's ability to detect and sanction the wrong. Thus, the amount of mitigation offered to many firms is not sufficient to encourage self-reporting and full cooperation in any situation where prosecutors would genuinely benefit from these activities.

Moreover, the structure of the Guidelines' mitigation provisions is perverse because the Guidelines grant a lower percentage reduction to firms with higher initial culpability scores, for example, large firms with culpable managers. Thus, rather than providing strong incentives to self-report to large firms detecting a violation involving high-level personnel, the Sentencing Commission structured the Organizational Sentencing Guidelines to create quite low incentives for these firms to self-report.⁶⁶ This structure is perverse because the enforcement staff is likely to derive the most benefit from self-reporting, full cooperation, and settlement when violations involve large firms, as these violations can be the hardest to detect and investigate and also are likely to cause the largest harm if they remain unreported.

To see the problem, examine Table One. Consider a large firm (5,000 employees) that has detected a violation involving high-level personnel. This firm would face an unmitigated culpability score of ten (if

65. *See id.* at 764.

66. A firm that faces an unmitigated culpability score of five obtains a culpability score of one if it self-reports, fully cooperates, and settles. This lowers the fine multiplier from one to two times the base fine to 0.2–0.4 times the base fine, which is 20% of the unmitigated sanction.

there were no other basis for aggravation).⁶⁷ Assume further that the firm has a prior history of the offense in the last five years. This firm now faces an unmitigated culpability score of twelve. Should this firm detect a wrong, it would face a fine of two–four times the base fine if it does not self-report, cooperate, and accept responsibility. If the firm does self-report, cooperate, and accept responsibility, it would get five points of mitigation and face a fine of 1.4–2.8 times the base fine. Thus, the firm is left subject to a sanction that is 70% of the unmitigated fine if it self-reports, cooperates, and accepts responsibility. This is not enough mitigation to induce self-reporting of violations where the probability that the enforcement staff will be able to detect the violation and sanction the firm on its own is less than 70%. By contrast, a firm that starts with a culpability score of five can get a 95% reduction in its fine by self-reporting, cooperating, and accepting responsibility. The decision to impose a higher fine on the shareholders of a large publicly-held firm that self-reports and cooperates than on the shareholders of a smaller firm is inconsistent with optimal deterrence. Indeed, corporate self-reporting is most needed when senior managers of large firms commit a crime, as they have the greatest capacity to cause serious harm and often are better able to avoid detection or sanction absent full corporate cooperation. Thus, the Organizational Sentencing Guidelines fails to adequately reward self-reporting and full cooperation where they are most needed.

Further analysis reveals that the preceding discussion understates the potentially perverse disincentive not to report that the Guidelines produce. Although the Guidelines provide that a firm can get a five point reduction in the culpability score if it self-reports, the marginal benefit to a firm of self-reporting often is far less than this. This is so for two reasons. First, a firm only gets five points of mitigation for self-reporting the crime if it also cooperates and accepts responsibility. Yet a firm that plans to cooperate and accept responsibility is eligible for a two point reduction in its culpability score for those acts alone. This implies that the marginal benefit to a firm of self-reporting is only a three point reduction in its culpability score, since it could get a two point reduction by just cooperating and accepting responsibility should the government detect the wrong.⁶⁸ Viewed from this perspective, we see that the Organizational Guidelines provide truly anemic levels of mitigation to firms that self-report.

Accordingly, a large firm (5,000 employees or more) that reports a crime involving high level personnel can expect no more than a 30%

67. ORGANIZATIONAL GUIDELINES § 8C2.5(a)–(b).

68. This discussion assumes that the firm does not have an effective compliance program.

TABLE ONE
EFFECT OF SELF-REPORTING, COOPERATING AND ACCEPTING
RESPONSIBILITY (5 PT)

Culpability Score	Unmitigated Multiplier (Min-Max)	Mitigated Culpability Score	Mitigated Minimum Multiplier	Mitigated Maximum Multiplier	Reduction Minimum Multiplier	Reduction Maximum Multiplier
14	2.00-4.00	9	1.80	3.60	10%	10%
13	2.00-4.00	8	1.60	3.20	20%	20%
12	2.00-4.00	7	1.40	2.80	30%	30%
11	2.00-4.00	6	1.20	2.40	40%	40%
10	2.00-4.00	5	1.00	2.00	50%	50%
9	1.80-3.60	4	0.80	1.60	56%	56%
8	1.60-3.20	3	0.60	1.20	63%	63%
7	1.40-2.80	2	0.40	0.80	71%	71%
6	1.20-2.40	1	0.20	0.40	83%	83%
5	1.00-2.00	0	0.05	0.20	95%	90%
4	0.80-1.60	-1	0.05	0.20	94%	88%
3	0.60-1.20	-2	0.05	0.20	92%	83%
2	0.40-0.80	-3	0.05	0.20	88%	75%
1	0.20-0.40	-4	0.05	0.20	75%	50%
0	0.05-0.20	-5	0.05	0.20	0%	0%

reduction in its fine. This implies that the firm still expects to pay 70% of the fine if it does report (assuming it does not cooperate). Letting F be the unmitigated base fine, this means that a large firm faces expected costs of

$$(\text{Probability Government Detects Crime on its Own})F$$

and expected sanctions of the following if it does report, where we recognize that if the firm reports but does not cooperate there is a (small) chance it can avoid sanction:

$$(\text{Probability of Government Sanction if no cooperation})(.7)F$$

As long as the difference between the probability that the government sanctions if the firm reports and the probability that the government detects the crime on its own is more than 30%, then the firm can only hurt itself by reporting. Indeed, if we assume that the government has an 80% chance of convicting a firm that self-reports a crime assuming it does not cooperate (which is likely an underestimate if the employees actually committed a crime), then the firm faces a choice between an expected sanction of $(.8)(.7)F = .56F$ if it does report and an expected fine of PF , if it does not report, where P is the probability that

the government is able to detect the wrong and sanction the firm if the firm does not report and cooperate. In this case, a firm only increases its expected cost if it self-reports, unless (as is unlikely) it expects that if it does not self-report there is at least a 56% chance that the government will detect the crime and convict the firm. There is little, if any, evidence to suggest that the government is even remotely that effective at detecting and convicting crimes by large firms absent corporate assistance. Thus, a firm facing the penalty regime created by the Guidelines is far better off ignoring evidence of potential crimes in the hope that the government will not detect it (and safe in the knowledge that if the government does detect it the firm can get at least two points of mitigation by cooperating and accepting responsibility).

TABLE TWO
MARGINAL BENEFIT OF SELF-REPORTING (3 PT)

Culpability Score	Unmitigated Multiplier (Min-Max)	Mitigated Culpability Score	Mitigated Minimum Multiplier	Mitigated Maximum Multiplier	Reduction Minimum Multiplier	Reduction Maximum Multiplier
14	2.00–4.00	11	2.00	4.00	0%	0%
13	2.00–4.00	10	2.00	4.00	0%	0%
12	2.00–4.00	9	1.80	3.60	10%	10%
11	2.00–4.00	8	1.60	3.20	20%	20%
10	2.00–4.00	7	1.40	2.80	30%	30%
9	1.80–3.60	6	1.20	2.40	33%	33%
8	1.60–3.20	5	1.00	2.00	38%	38%
7	1.40–2.80	4	0.80	1.60	43%	43%
6	1.20–2.40	3	0.60	1.20	50%	50%
5	1.00–2.00	2	0.40	0.80	60%	60%
4	0.80–1.60	1	0.20	0.40	75%	75%
3	0.60–1.20	0	0.05	0.20	92%	83%
2	0.40–0.80	-1	0.05	0.20	88%	75%
1	0.20–0.40	-2	0.05	0.20	75%	50%
0	0.05–0.20	-3	0.05	0.20	0%	0%

Examining Table Two, we see that, once we take this consideration into account, the Organizational Guidelines do little to encourage reporting by any firm with a culpability score over five—which means that larger firms generally get little credit for reporting crimes such as fraud. As previously discussed, firms with more than 200 employees can expect to have a culpability score of at least eight for most crimes, such as health care fraud, securities fraud, and false claims, that tend to

involve the participation of either high level personnel of the unit (or the firm) or multiple supervisory personnel. This implies that firms with 200 or more employees regularly start with an unmitigated culpability score of at least eight. None of these firms can obtain even a 40% reduction in their fine if they report. Thus, as long as the government has less than a 60% chance of detecting the crime on its own, these firms fare better if they do not report. Indeed, we see that the Guidelines deter self-reporting when it is most needed—when the government would be unlikely to detect the crime on its own but could obtain the evidence needed to sanction wrongdoers if the firm does report.⁶⁹

Beyond this, the Sentencing Commission gives firms that did not self-detect the wrong (and thus did not self-report it) far too little incentive to cooperate and accept responsibility. The problem, once again, is particularly severe in the case of large firms. Firms that cooperate and accept responsibility, in effect, end up guaranteeing their own conviction

69. This analysis of the marginal benefit of reporting understates the marginal benefit of reporting to some firms: those firms eligible for mitigation based on their adoption of an effective compliance program. The marginal benefit of reporting a detected wrong for a firm with an effective compliance program is higher than three because a firm with an effective compliance program is potentially eligible for a three-point reduction in its culpability score, but only if it self-reports any detected wrongs. Consequently, for these firms the marginal benefit of self-reporting is the six-point reduction in the culpability score the firm gets for both the effective compliance program and for self-reporting (recognizing that it only gets the credit for self-reporting if it plans to cooperate and accept responsibility, in which case it will get an additional two points of mitigation).

Nevertheless, the conclusion remains that the Guidelines' penalty regime does not provide larger firms with sufficient incentive to self-report detected wrongdoing if high-level personnel or supervisory-authority personnel were involved in or condoned the crime. Specifically, the Guidelines provide substantial mitigation to smaller firms but much less to firms with 1,000 employees or more (and managerial involvement). This pattern is perverse because compliance programs are far more important for larger firms than small ones. Managers of small firms can more easily obtain good information about the firm's operations and risks during the course of normal operations. By contrast, directors and managers of large firms need the information and oversight that a good compliance program can provide. Moreover, the government is likely to get greater marginal benefit from the combined effect of an effective corporate compliance program and self-reporting when a firm is large than when it is small. This is because larger firms' operations are more complex, and thus larger firms may be better able to hide crimes such as fraud. Thus, the government often will have a harder time detecting the crime if the larger firms do not self-report and may have an equally hard time convicting wrongdoers without the evidence that a good compliance program provides.

Moreover, not only has the Sentencing Commission provided small firms with larger incentives to adopt an effective compliance program and self-report than larger firms, but the magnitude of the benefit provided to larger firms is not enough to induce firms to adopt an effective compliance program and self-report, except in those circumstances where the combined effect of an effective compliance program and self-reporting has relatively little marginal effect on the probability of detection and sanction. This condition holds only if the government is very likely to detect and sanction the crime even if the firm does not have an effective compliance program and self-reports or if the firm is very likely to escape sanction even if it reports and cooperates. For most crimes, these conditions are unlikely to arise.

most of the time. Yet the Sentencing Commission structured the Guidelines so that a large firm with at least 5,000 employees (and complicit higher-level personnel) receives only a 20% reduction in its expected fine in return for its cooperation if they did not self-report the wrong, even if the firm's cooperation enables the government to obtain convictions (of the firm and the responsible individuals) that it likely could not otherwise obtain. To see this, consider Table Three. A firm with at least 1,000 employees only receives a 22% reduction in its expected fine for cooperation (if it did not self-report). This is reasonable if corporate cooperation has little effect on the government's ability to sanction the firm and the responsible individuals. Yet often this is not the case. Indeed, as we shall see in Section Three, the DOJ has concluded that in many cases (especially those involving large firms) corporate cooperation is vitally important. If this cooperation increases the probability of sanction by even 25%, firms subject to the Guidelines will be loath to provide it.⁷⁰

Moreover, the deficiencies of the Organizational Guidelines are more apparent once we recognize that the firms obtain a lower percentage reduction in their expected sanction than the mitigation provisions appear to grant. The mitigation provisions generally only relate to the criminal fine. Yet firms convicted of a corporate crime often are subject to criminal restitution and/or remedial orders in addition to the fine.⁷¹ Where the base fine equals the harm caused or gain to the firm, these "non-fine" sanctions can, in effect, increase the multiplier by one, so that a firm paying a criminal fine of two to four times the base fine can expect a total penalty of three to five times the base fine once criminal restitution or remedial orders are taken into account.⁷² Given this, we see that the benefit of self-reporting, cooperating, and accepting responsibility is far less than it first appeared, because these activities reduce the criminal fine but do not necessarily affect criminal restitution or remediation penalties. Accordingly, if we look at the effect of self-reporting, cooperating, and accepting responsibility on the total expected criminal penalty, we see that firms rarely can expect as much as a 50% reduction in their expected criminal penalty if remediation/restitution payments only equal the base fine. The problem is pronounced for firms

70. The Guidelines allow judges to depart from the Sentencing Guidelines if the government files a motion saying that the firm has provided substantial assistance in the investigation. ORGANIZATIONAL GUIDELINES § 8C4.1. Nevertheless, the amount of mitigation encouraged by the Guidelines themselves generally is inadequate to induce cooperation, especially by larger firms with respect to crimes involving managers.

71. ORGANIZATIONAL GUIDELINES § 8B1.1-3.

72. This effect is muted to the extent that the firm also is subject to a government-imposed civil penalty that is reduced by the amount of restitution or to the extent that restitution reduces private civil liability.

TABLE THREE
EFFECT OF COOPERATING AND ACCEPTING RESPONSIBILITY
(2 PT)

Culpability Score	Unmitigated Multiplier (Min-Max)	Mitigated Culpability Score	Mitigated Minimum Multiplier	Mitigated Maximum Multiplier	Reduction Minimum Multiplier	Reduction Maximum Multiplier
14	2.00–4.00	12	2.00	4.00	0%	0%
13	2.00–4.00	11	2.00	4.00	0%	0%
12	2.00–4.00	10	2.00	4.00	0%	0%
11	2.00–4.00	9	1.80	3.60	10%	10%
10	2.00–4.00	8	1.60	3.20	20%	20%
9	1.80–3.60	7	1.40	2.80	22%	22%
8	1.60–3.20	6	1.20	2.40	25%	25%
7	1.40–2.80	5	1.00	2.00	29%	29%
6	1.20–2.40	4	0.80	1.60	33%	33%
5	1.00–2.00	3	0.60	1.20	40%	40%
4	0.80–1.60	2	0.40	0.80	50%	50%
3	0.60–1.20	1	0.20	0.40	67%	67%
2	0.40–0.80	0	0.05	0.20	88%	75%
1	0.20–0.40	-1	0.05	0.20	75%	50%
0	0.05–0.20	-2	0.05	0.20	0%	0%

whose unmitigated culpability score exceeds six—which is to say firms (with greater than 200 employees) whose managers were complicit in the crime. Such firms would be better off not self-reporting detected crimes if they expect to fall under the Guidelines and if there is less than a 50% chance that the government will detect the wrong if the firm does not report it.⁷³

3. MITIGATION PROVISIONS GOVERNING EFFECTIVE COMPLIANCE PROGRAMS

The Sentencing Commission also needed to structure the mitigation provisions to encourage firms to adopt an effective compliance program. Yet the Organizational Guidelines it adopted do not provide adequate incentives to adopt compliance programs that materially enhance the probability that crimes are detected.

The Organizational Guidelines need to provide substantial mitiga-

73. *But see supra* note 69 and accompanying text (explaining that the marginal benefit of self-reporting is higher if the firm can be confident of getting credit for having an effective compliance program if it self-reports the wrong).

TABLE FOUR
EFFECT OF SELF-REPORTING, COOPERATING AND ACCEPTING
RESPONSIBILITY (5 PT)

Culpability Score	Unmitigated Multiplier (Min-Max)	Mitigated Culpability Score	Mitigated Multiplier	Reduction Minimum Multiplier	Reduction Maximum Multiplier
14	3.00-5.00	9	2.80-4.60	7%	8%
13	3.00-5.00	8	2.60-4.20	13%	16%
12	3.00-5.00	7	2.40-3.80	20%	24%
11	3.00-5.00	6	2.20-3.40	27%	32%
10	3.00-5.00	5	2.00-3.00	33%	40%
9	2.80-4.60	4	1.80-2.60	36%	43%
8	2.60-4.20	3	1.60-2.20	38%	48%
7	2.40-3.80	2	1.40-1.80	42%	53%
6	2.20-3.40	1	1.20-1.40	45%	59%
5	2.00-3.00	0	1.05-1.20	48%	60%
4	1.80-2.60	-1	1.05-1.20	42%	54%
3	1.60-2.20	-2	1.05-1.20	34%	45%
2	1.40-1.80	-3	1.05-1.20	25%	33%
1	1.20-1.40	-4	1.05-1.20	13%	14%
0	1.05-1.20	-5	1.05-1.20	0%	0%

tion to induce firms to adopt truly effective compliance programs that materially increase the probability that crimes are detected. Mitigation is especially important since organizations cannot get compliance program mitigation unless they promptly self-report any detected wrongdoing. Thus, the amount of mitigation must be sufficient to not only induce the firm to aggressively attempt to detect crimes, but also to report detected wrongs to the government (which materially enhances the probability that the government can convict it).

In order to understand the problems plaguing the Guidelines' provisions governing compliance programs, we first need to determine what should be the goal of a sentencing regime vis-à-vis corporate compliance. Corporate compliance programs are designed to deter violations directly by training employees and shifting corporate culture. They also are designed to deter crime indirectly by increasing the probability that wrongs will be detected, thereby increasing the expected sanction for corporate crime (where the latter is the sanction amount multiplied by the probability of sanction). Both the indirect and direct effects of com-

pliance programs benefit society by deterring crimes. The magnitude of this benefit equals the social cost of the crimes deterred. Society benefits when firms adopt all cost-justified compliance program measures: measures where the social benefit of the crimes deterred equals or exceeds the social cost of the compliance measure.

It might seem that the state could induce firms to adopt all cost-justified compliance measures by holding them strictly liable for their employees' crimes, subject to an expected sanction that equals the social cost of the crime. It might seem that this ensures that firms would adopt any compliance measure where the cost of the measure is less than or equal to the social benefit of the crimes deterred. This is not the case. The problem is that a firm held strictly liable for its employees' crimes (and subject to a fixed fine) obtains less benefit from compliance than does society. True it gets the benefit of the crimes deterred. But effective compliance programs designed to detect wrongdoing impose a cost on firms subject to strict corporate liability in the form of an increase in the firm's expected liability for any crimes that are committed. Absent substantial sanction mitigation, firms held liable for their employees' crimes face the real possibility that adopting an effective compliance program will increase the firm's expected liability for its employees' crimes. The best way for the state to ensure that the threat of criminal penalties does not deter the adoption of a compliance program is to structure penalties so that there is no liability enhancement effect. Specifically, the government should subject firms to a lower penalty if they had an effective compliance program and should ensure that the amount of mitigation at least equals the effect of an effective compliance program on the probability that any crime committed will be detected and sanctioned (assuming that the firm reports any detected wrongs).⁷⁴

Examining the Organizational Guidelines, we see that they do provide some firms with strong incentives to adopt a compliance program. Nevertheless, they do not provide adequate incentives in those situations where an effective compliance program is most important—firms with a past history of wrongdoing or where the crime is committed or condoned by managers. To see this, consider Table Five. Table Five reveals that firms with an unmitigated culpability score over five receive little mitigation for adopting an effective compliance program. The firms

74. For a discussion of the precise conditions governing the optimal minimum amount of mitigation, see generally Arlen & Kraakman, *supra* note 3. For a discussion of why the state should focus on eliminating the liability enhancement effect if firms obtain the full social benefit of any crimes they deter, see Arlen, *Corporate Criminal Liability*, *supra* note 1, at 57–59. The probability of sanction should be based on the probability of sanction when the firm reports detected wrongdoing because firms only get credit for adopting an effective compliance program if they promptly report any wrongs they detect. ORGANIZATIONAL GUIDELINES § 8C2.5(f)(2).

TABLE FIVE
IMPACT ON CORPORATE FINE OF AN EFFECTIVE COMPLIANCE
PROGRAM (3PT)

Culpability Score	Unmitigated Multiplier (Min-Max)	Mitigated Culpability Score	Mitigated Multiplier	Reduction Minimum Multiplier	Reduction Maximum Multiplier
14	2.00-4.00	11	2.00-4.00	0%	0%
13	2.00-4.00	10	2.00-4.00	0%	0%
12	2.00-4.00	9	1.80-3.60	10%	10%
11	2.00-4.00	8	1.60-3.20	20%	20%
10	2.00-4.00	7	1.40-2.80	30%	30%
9	1.80-3.60	6	1.20-2.40	33%	33%
8	1.60-3.20	5	1.00-2.00	38%	38%
7	1.40-2.80	4	0.80-1.60	43%	43%
6	1.20-2.40	3	0.60-1.20	50%	50%
5	1.00-2.00	2	0.40-0.80	60%	60%
4	0.80-1.60	1	0.20-0.40	75%	75%
3	0.60-1.20	0	0.05-0.20	92%	83%
2	0.40-0.80	-1	0.05-0.20	88%	75%
1	0.20-0.40	-2	0.05-0.20	75%	50%
0	0.05-0.20	-3	0.05-0.20	0%	0%

likely to fall into this category are firms that were previously found to have committed a similar offense by civil or criminal authorities and firms with wrongdoing that implicates high-level personnel or multiple supervisory authority personnel. Providing anemic mitigation to these firms is perverse because it is particularly important for a firm to have an effective compliance program if the firm faces a material risk of wrongdoing by people in authority within the firm or the firm has a previous history of wrongdoing, such that there is a heightened risk of future wrongdoing.

To see the problems with the Organizational Guidelines, consider a firm with 1,000 or more employees that anticipates managerial involvement in any criminal activity. This firm is eligible for only a 30-33% reduction in the criminal fine for adopting an effective compliance program, even if that program materially enhances the firm's ability to detect the wrong and provides the government with important evidence. This 30-33% reduction in the penalty is not very large, especially when compared to the negative consequences to the firm of adopting a compli-

ance program. After all, a compliance program, when effective, can materially enhance the likelihood that the firm detects any violations that occur. It also can materially enhance the government's ability to obtain evidence about the crime should the government detect the wrong on its own. As a result, an effective compliance program can materially enhance the likelihood that the firm not only pays a criminal fine, as well as criminal restitution/remediation, government-imposed civil penalties, and also (in some cases) private civil sanctions. Accordingly, a firm contemplating a compliance program that will not deter all wrongs, and that can increase the probability that the government detects and sanctions the wrong by more than 30–33%, would be better off refraining from adopting the program in favor of “cosmetic compliance” if the firm expects its sanctions to be governed by the Organizational Guidelines.⁷⁵

To elucidate further, consider a firm with 1,000 employees that expects that seven crimes could occur over a given period of time if it does not adopt a compliance program. Assume that the probability that the government can detect and sanction these crimes is only 1/10 if the firm does not assist by adopting a compliance program. Assume that the firm can adopt a compliance program, at cost C , that would more than double the probability of detection (and sanction) from 1/10 to 1/4. Assume that three crimes would be deterred by this increase in individual wrongdoers' probability of being sanctioned. Now consider the effect of the Organizational Guidelines. Let F be the unmitigated fine. The firm would face an expected sanction of $7(1/10)F$ if it does not adopt an effective compliance program, and expected costs of $C + 4(1/4)(.67)(F)$ if it does. Assume moreover that the compliance program would cost as much to implement as the expected sanction for one (unmitigated crime). Given this, the firm will compare $(6/10)F(.67)F$ with $(4/4)(.67)F = (.67)F$. Since the latter is greater than the former, the firm is better off if it does not adopt an effective compliance program than if it does, because the amount of mitigation granted for having a compliance program is less than the beneficial effect of compliance on the probability that crimes are detected and sanctioned.

To illustrate further, assume that a firm expects one violation to occur per period, with or without a compliance program, but potentially values the compliance program because it would double the firm's ability to detect each violation from 50% to 100%. In this situation, the firm would be deterred from adopting the compliance program by the Guidelines, even if the enforcement staff reassures the firm that it would grant full mitigation for an effective compliance program that detects viola-

75. See Arlen & Kraakman, *supra* note 3, at 746–47.

tions tolerated by substantial authority personnel notwithstanding the presumption against it. The Guidelines would deter compliance because this firm would face a potential sanction of two to four times the base fine⁷⁶ if it does not adopt an effective compliance program—but the firm would face only a 50% chance of its wrongdoing being detected and sanctioned. This translates into an *expected* sanction that is one to two times the base fine—where the expected sanction is the actual sanction multiplied by the probability of the sanction being imposed. By contrast, if the firm adopts an effective compliance program, and reports all detected wrongdoing, it would be subject to a penalty of 1.4–2.8 times the base penalty, but it would face this penalty with certainty. Thus, adopting a compliance program would increase the firm's expected penalty from one to two times to 1.4–2.8 times the base penalty, if it is granted mitigation.

Thus, even though the Guidelines reduce the *actual* penalty, the firm's *expected* (probability-adjusted) penalty is higher if it adopts an effective compliance program than if it does not. This is because the Guidelines do not grant sufficient mitigation to counteract the increased risk of detection and sanction for firms with effective compliance programs that promptly report. As a result, the firm would be much better off not adopting an effective program to detect violations.⁷⁷

The Organizational Guidelines provide even less incentive for firms to adopt a compliance program if the firm potentially faces an unmitigated culpability score that exceeds ten because firms with culpability scores of ten and higher are subject to the same penalty multipliers. Thus, reducing the firm's culpability score from fourteen to ten has no effect on the fine to which it can be subject. This undermines the incentives of many large firms to adopt an effective compliance program.

To see this, consider a firm with a pre-mitigation culpability score of eleven because it is a large firm (over 5,000 employees), supervisory authority personnel tolerated the violation, and it had a prior violation. Assume that the firm is able to demonstrate that its compliance program was effective and thus is eligible for the three points of penalty mitigation awarded to firms that adopt an effective compliance program (and

76. This is because the firm receives a base culpability score of five plus an increase of five points for the participation of high-level personnel in a large organization, resulting in a score of ten points, which produces a multiplier of two to four times the base penalty.

77. Thus, the Organizational Guidelines only encourage firms to adopt effective compliance programs when the deterrence effect of a compliance program—as measured by the benefit to the firm of the reduction in the expected number of wrongs resulting from adoption of the program—exceeds the firm's enhanced expected liability for each violation that occurs notwithstanding its compliance program under the anemic mitigation provisions for compliance in the Organizational Guidelines. See generally Arlen, *Corporate Criminal Liability*, *supra* note 1; Arlen & Kraakman, *supra* note 3.

also self-report). For this firm, the three points of mitigation translates into only two points of mitigation, since it gets no credit for the move from eleven to ten. Thus, the firm is left with a mitigated penalty equal to 80% of the unmitigated penalty. This expected burden is more likely to deter genuine efforts to detect wrongdoing than encourage them.

Indeed, the problem is worse than the preceding analysis suggests because effective compliance programs increase the firm's probability of being subject to a variety of sanctions beyond the criminal fine. These include criminal restitution as well as government and private civil penalties. Yet, as previously mentioned, the Guidelines only reduce the criminal fine, and not other sanctions. Thus, the percentage reduction in the firm's expected sanction produced by the Guidelines is lower than Table Five would suggest. Thus, the Guidelines may deter firms from adopting an effective compliance program even if the compliance program would increase the probability of sanction by less than the percentage of mitigation of the criminal fine.

Moreover, the Guidelines' mitigation provisions do not provide adequate incentives for firms to adopt compliance programs even if the firm does not expect managers to be complicit in the crime. Here the problem lies with the interaction between the mitigation provisions for having an effective compliance program and those for reporting, cooperating, and accepting responsibility. A firm that does not expect high level personnel to be complicit can expect to have an unmitigated culpability score of five. Firms with a culpability score of five derive little genuine benefit from having a compliance program as long as the firm is much better able to detect crime than is the government. This is because the firm knows that if a crime occurs, it will detect it first. In this case, the firm can obtain five points of mitigation for self-reporting, cooperating, and accepting responsibility. It accordingly has no reason to also adopt a compliance program, especially since the firm is only entitled to mitigation for the compliance program if it self-reports any crimes it detects. Accordingly, when the firm does not expect the government to detect the wrong before it does, the firm obtains little marginal benefit from having an effective compliance program. In this situation, the firm often will be better off not adopting an effective compliance program (while still self-reporting any wrongs it happens to detect). As a result of this structure, the Guidelines' mitigation provisions do not encourage firms to adopt compliance programs aimed at detecting wrongs by non-managerial employees if the firm has no prior history and expects that it will learn of any violations before the government authorities do.

Thus, the Guidelines' mitigation provisions governing compliance programs fail to achieve the important objective of encouraging firms to

adopt measures designed to detect violations of the law because these provisions do not grant sufficient mitigation—either alone or in concert—to ensure that firms face lower expected penalties if they intervene effectively to detect violations than if they do not. This failure to grant adequate mitigation for compliance is particularly troubling because the Guidelines should be encouraging firms to adopt effective compliance programs because the government can best reduce and remedy the harm caused by violations if it can induce firms to help it detect them as quickly as possible. Thus, the Sentencing Commission should restructure the Guidelines to ensure that they provide firms substantial financial incentives to undertake each of these activities—detection, reporting, and full cooperation—separately and together.

3. DEPARTMENT OF JUSTICE APPROACH TO MITIGATION

Careful consideration of the incentives created by the Organizational Guidelines reveals that they do not serve a central goal of helping to deter crime by inducing firms to adopt effective compliance programs, self-report, or fully cooperate. Indeed, in many circumstances, the Organizational Guidelines discourage firms from investing in measures to detect and report evidence of wrongdoing and assist in the conviction of individual wrongdoers.

The conclusion that the Organizational Guidelines are ineffective is consistent with the Department of Justice's decision to adopt its own approach to sanction mitigation for corporate policing. In the early 1990s, firms whose employees committed federal crimes in the scope of employment faced a *de jure* regime of strict corporate criminal liability; the criminal sanctions imposed were determined by the Organizational Guidelines. Thus, firms faced the threat of criminal liability whenever an employee committed a crime for which it was vicariously criminally liable. Under this approach, judges could grant mitigation to firms that adopted a compliance program, but only in certain circumstances.⁷⁸ They also could grant credit for self-reporting and cooperating, but, as shown above, the amount of mitigation was not sufficient to truly encourage firms to adopt effective compliance programs, self-report crimes that otherwise might go undetected, and fully cooperate with government investigations.

Recognizing the need to provide firms with stronger incentives to

78. ORGANIZATIONAL GUIDELINES § 8C2.5(f)(3). Also, at the time under the Organizational Sentencing Guidelines, firms adopting a compliance program were not entitled to sanction mitigation if a person within the organization's high-level or supervisory authority personnel participated in, condoned, or was willfully ignorant of the offense. *See supra* text accompanying note 24.

detect crimes, report them, and fully cooperate, in 1999 then-Deputy Attorney General Eric Holder effectively adopted an alternative regime to govern the sanctioning of firms that adopted an effective compliance program, self-reported, or fully cooperated with federal authorities.⁷⁹ He issued a set of guidelines to prosecutors outlining the factors that prosecutors should consider in deciding whether to prosecute a corporation for its employees' crimes. Of particular importance, the Holder Memo stated that, in deciding whether to exempt a corporation from prosecution, prosecutors should consider the effectiveness of the firm's compliance program, whether it promptly reported the crime, and its level of cooperation with the government.⁸⁰

In contrast to the Organizational Sentencing Guidelines, prosecutors governed by the Holder Memo (and the prosecutorial guidelines that superseded it)⁸¹ can grant firms full insulation from prosecution in return for satisfying their corporate policing duties. Moreover, prosecutors can, and regularly do, decide not to indict a firm for its employees' criminal conduct, even when the firm only partially satisfied its policing duties.⁸² In particular, the prosecutorial guidelines permit full leniency even if the firm did not have an effective compliance program. Prosecutors often do not indict firms that fully cooperate with federal authorities.⁸³ This stands in dramatic contrast with the Organizational Sentencing Guidelines, under which firms are subject to conviction even if they had an effective compliance program, self-reported, and fully cooperated. This distinction is important to the extent that firms convicted of crimes are subject to collateral penalties or reputation sanctions not imposed on

79. The Holder Memo was the first effort to adopt a duty-based regime applicable to a broad range of federal corporate crimes. Prior to the Holder Memo, individual U.S. Attorneys had employed non-prosecution to encourage cooperation. Moreover, individual federal enforcement authorities also had adopted similar policies governing specific crimes. Arlen, *Corporate Criminal Liability*, *supra* note 1, at 10–11. For a discussion of the evolution of the federal corporate criminal enforcement, see Jennifer Arlen, *The Story of Allis-Chalmers, Caremark, and Stone: Directors' Evolving Duty to Monitor*, in *CORPORATE LAW STORIES* 330–31 (J. Mark Ramseyer ed., 2009).

80. Holder Memo, *supra* note 18, § II.A.4–6.

81. *See id.* § II.B.

82. *See* sources cited *supra* note 79 (discussing the evolution of corporate criminal enforcement); *see also supra* note 19 and citations therein (discussing DPAs and NPAs).

83. The conclusion that firms that cooperate can get full leniency even if the firm did not have an effective compliance program follows from a review of the DOJ's DPAs and NPAs. Many (if not most) of these agreements require firms to adopt compliance programs containing specific features—mandates that would not be necessary if prosecutors only granted leniency to firms that already had effective compliance programs. For a discussion of the content of the DOJ's DPAs and NPAs, *see, e.g.*, Arlen & Kahan, *supra* note 19; Garrett, *Structural Reform Prosecution*, *supra* note 19; Spivack & Raman, *supra* note 19; *see also* Khanna & Dickinson, *supra* note 19.

firms subject to purely civil penalties.⁸⁴

The DOJ also appears to deviate from the Organizational Guidelines in determining the magnitude of any penalties imposed on firms that engage in effective policing. Under the DOJ's non-prosecution policy, firms granted protection from indictment generally are required to pay a penalty, as well as remediation, which is imposed on them through a DPA or NPA.⁸⁵ In determining the magnitude of this penalty, prosecutors are free to take into account the firm's good behavior, including its compliance efforts. In contrast with the original Organizational Sentencing Guidelines, under the DOJ's non-prosecution policy, prosecutors can reduce the penalty for a firm with an effective compliance program even if the violation involved high-level personnel and the firm did not detect the crime. Moreover, the magnitude of sanction mitigation for firms that avoid prosecution by policing often is significantly greater than the amount available under the Organizational Sentencing Guidelines. In part, this is because the leniency program enables firms to avoid the enormous collateral consequences of a conviction, whereas the Organizational Sentencing Guidelines do not. In addition, unlike the Organizational Sentencing Guidelines, under the DOJ's leniency program, prosecutors can decide not to impose a criminal fine at all. While the firm may be subject to a penalty imposed through a NPA or DPA, the DOJ has the freedom to ensure that firms have lower total sanctions (criminal and civil) than would be imposed if criminal penalties were determined by the Organizational Guidelines.⁸⁶ The DOJ's decision to ensure that firms are able to get a substantially greater benefit for effective compliance, self-reporting, and full cooperation than is available under the Organizational Sentencing Guidelines appears to reflect the DOJ's recognition that it cannot achieve its central corporate enforcement goal of deterring corporate crime unless it grants far more mitigation for good corporate conduct, in a broader set of circumstances, than would be permitted under the Organizational Guidelines.⁸⁷

The DOJ policy highlights that the problems with the Organizational Guidelines identified here are real. Unfortunately, the DOJ policy is not a complete solution to these problems because, notwithstanding the DOJ policy, there are situations where the Organizational Guidelines still are important. In particular, some firms are convicted even though

84. See generally Arlen, *Corporate Criminal Liability*, *supra* note 1 (discussing collateral and market-based sanctions for corporate crime).

85. See Arlen & Kahan, *supra* note 19 (discussing the content of these agreements); see also Garrett, *Structural Reform Prosecution*, *supra* note 19 (discussing the same).

86. This is based on an examination of NPAs and DPAs on file with the author.

87. The original Guidelines had additional flaws beyond those discussed here, as do the current Guidelines. See *supra* note 24 and accompanying text.

they self-reported the wrong, had an effective compliance program, or cooperated.⁸⁸ Firms that expect to be convicted for the crimes their employees commit thus continue to look to the Guidelines to determine whether they should adopt a truly effective compliance program, self-report detected wrongs, and fully cooperate. The present analysis of the Organizational Sentencing Guidelines reveals that many firms in this situation will conclude that they should not pursue these corporate policing measures. Thus, the Guidelines fail to achieve a vital enforcement objective of inducing effective corporate monitoring, self-reporting, and cooperation. The Sentencing Commission thus should redraft its Guidelines to more effectively encourage detection, self-reporting, and full cooperation by organizations.

4. CONCLUSION

The Sentencing Commission could have benefitted both potential victims of crimes and firms by adopting Sentencing Guidelines designed to deter violations by inducing effective corporate policing. Consumers and firms both would have benefitted from the heightened incentives to pursue aggressive corporate policing that effective guidelines can provide. Unfortunately, the Sentencing Commission failed to adopt Guidelines that adequately encourage firms to help detect, self-report, and sanction wrongdoing. Indeed, the Organizational Guidelines may actively deter some firms from adopting effective policing measures designed to deter wrongdoing—for example, compliance, self-reporting, and cooperation—because they impose a greater expected penalty on firms that undertake these desired activities than on those that do not.

Firms cannot be relied on to invest in measures that help government authorities detect and sanction wrongdoing unless the Sentencing Commission structures its Guidelines to ensure that firms face lower expected sanctions when they monitor, self-report, and fully-cooperate than when they do not. Yet, the Organizational Guidelines do not grant enough mitigation for adopting effective compliance programs, self-reporting, or cooperating to induce organizations to actively pursue these measures. Indeed, the Organizational Sentencing Guidelines create the largest disincentive to engage in effective policing in the very situation where it is most needed: where the firm is substantially better able to detect and sanction violations if firms monitor, self-report, and fully cooperate. Moreover, the Guidelines grant proportionately less mitigation to large firms than to many smaller ones, all else equal. Thus, these

88. *See supra* note 22 (explaining how the Guidelines remain relevant notwithstanding the DOJ's leniency policy because firms that cooperate continue to be convicted and sentenced under the Guidelines).

guidelines perversely discourage policing by the very organizations—large complex organizations—that we most want to invest in optimal policing.

The DOJ has reduced the negative effect of the Organizational Guidelines through a non-prosecution policy that enables firms that engage in effective corporate policing to avoid conviction—and thus to also have their sanction determined outside the Guidelines. Nevertheless, not all firms that have effective compliance programs or self-report wrongs are sanctioned through this leniency policy. To the extent that the Organizational Guidelines thus remain effective, it is vital that the Sentencing Commission revise them to provide adequate mitigation for compliance, self-reporting, and cooperation.