



Vol. 24 No. 9

March 13, 2009

VICARIOUS CORPORATE LIABILITY: JUDGES SHOULD CREDIT DILIGENT COMPLIANCE WHEN EVALUATING CRIMINAL INTENT

by

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Companies are subject to criminal liability in the United States for conduct that is neither authorized nor condoned. The perceived misconduct even could have been directly contrary to the company's established and well-enforced business policies and ethical requirements. This seemingly bizarre conclusion results from a legal standard that holds the company criminally responsible for nearly all of the conduct of its employees. It is only necessary that the employee be motivated in some small part by a desire to benefit the company. It does not matter that the predominant intent was to secure a personal gain, that the potential corporate benefit was totally unrealistic, or that no benefit actually was realized by the company. In essence, the fate of the company is controlled by the individual decisions of nearly every employee – largely without regard to the company's efforts to prevent misconduct.

A criminal charge can be devastating for the company even when based on this liberal legal standard. Before the government is required to present any evidence in support of the allegations, the company may have already effectively lost. Its reputation in the business community may have been destroyed, its customer base may have evaporated, its access to capital markets and financing may have been foreclosed or become significantly more expensive, its market capitalization may have plummeted, and it may have been prevented from participating in programs funded by the government. Exoneration after trial may be meaningless – the destruction of Arthur Andersen is a graphic example. The U.S. Supreme Court's reversal of the Arthur Andersen conviction did nothing to resurrect the company.

The combination of a low legal standard and the catastrophic effects of a corporate criminal indictment affords the government enormous power. Its exercise of discretion to charge an offense or decline prosecution can determine whether a viable company will continue to exist. Confronting this reality, a company is subject to overwhelming pressure to do whatever is necessary to persuade the government not to indict. This is an advantage the government has learned to exploit. To demonstrate cooperation and enhance the prospect of a favorable resolution, companies have waived privileges and disclosed confidential information to advance the government's investigation, refused to cooperate with or indemnify their own executives and employees, and even promised to inform the government of their employees' defense activities and information requests. The government's relentless exercise of its power recently has drawn judicial criticism, *United States v. Stein*, 541 F.3d 130 (2d Cir. 2008), and congressional review, Attorney-Client Privilege Protection Act of 2008, S-3217, 110th Cong. (2008).

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Consideration should be given to restoring some balance to this process. One approach would be to require the government to carefully review a company's compliance program and efforts. Before a criminal charge could be brought against the company, the government should be required to conclude that the compliance program failed to meet objective standards of reasonableness and effectiveness. Similarly, as an element of establishing the alleged offense, courts should require the government to prove a company failed to implement an effective compliance program. Such an approach by the government and the courts would reserve liability for those companies that refused to meet their compliance responsibilities, and would not hold companies criminally responsible for misconduct that their best compliance efforts were unable to prevent.

The Development of Corporate Criminal Liability. Corporations have not always been subjected to broad theories of criminal liability. Under English common law, corporations were exempt from criminal prosecution. This approach, however, did not survive the emergence of the industrial revolution. Corporations began to play an increasing role in commerce and regulation became important. But even as late as the 1890s, corporations in the United States generally were not indictable for an offense that required proof of bad intent. *State v. First National Bank*, 2 S.D. 568, 571, 51 N.W. 587 (1892).

Modern corporate criminal liability stems from the 1909 decision of the United States Supreme Court in *New York Central & Hudson River Railroad v. United States*, 212 U.S. 41 (1909). The railroad was convicted of violating a statute that specifically held the company responsible for the acts of its officers, agents, and employees. On appeal, the company challenged the constitutionality of the statutory provision imposing vicarious corporate liability. The Court sustained the statute in part as an appropriate congressional application of the power to regulate interstate commerce.

Although the *New York Central* decision involved the application of specific statutory authority, the case has been interpreted broadly to support the concept that companies are vicariously liable for the acts of agents even when the statute that allegedly was violated contained no such specific authorization. It is only necessary that the agent act within the scope of authority granted by the company and that the purpose of the misconduct not be solely for personal gain.

The progressive application of the elements of the *New York Central* decision has greatly eroded the potential protection for the corporation against liability based on the acts of its agents. The Supreme Court required that misconduct occur within the scope of the agent's employment. This has been interpreted very broadly and is of little help. In accordance with general agency law, it is only necessary for the agent to have possessed apparent authority to engage in the conduct that supports the violation. *See, e.g., United States v. Inv. Enters., Inc.*, 10 F.3d 263, 266 (5th Cir. 1993). Thus, the company can be held criminally liable for conduct committed outside of the employee's actual authority so long as a third party reasonably believed the employee possessed that authority.

Similarly, the concept that the employee must have intended to benefit the company has been severely limited. Such benefit need only be one aspect of the employee's intent, even if personal gain to the employee was the predominant motivating factor. *See, e.g., United States v. Automated Med. Labs., Inc.* 770 F.2d 399, 407 (4th Cir. 1985); *United States v. Bainbridge Mgmt.*, 202 WL 31006135 (N.D. Ill. 2002). There is no requirement that the company actually receive a benefit, or that the possible benefit be a reasonable result of the employee's conduct. Totally misguided activity is sufficient so long as the employee believed such benefit could result.

Moreover, the government is not even required to prove that at least one individual knew all of the facts necessary to establish the alleged crime. Instead, the company can be criminally liable if a series of employees each understood some factors which in the aggregate would be sufficient to support liability. The corporation is charged with the "collective knowledge" of all of its executives, employees, and agents. *United States v. Bank of New England*, 821 F.2d 844 (1st Cir. 1987).

In its broadest application, this legal theory results in the imposition of corporate criminal liability even for misconduct that is directly contrary to corporate policy or express instruction. The decision in the *Hilton Hotels* case, which is often cited by the government, is a prime example. *United States v. Hilton Hotels Corp.*,

467 F.2d 1000, 1004-07 (9th Cir. 1972). In *Hilton Hotels*, the company was convicted of an antitrust offense because its agent engaged in conduct the hotel management twice stated should not occur. The agent testified that he violated those instructions because of “anger and personal pique toward the individual representing the supplier.” Nevertheless, the company was held criminally responsible for its employee’s conduct.

The conclusion is clear. Corporate criminal liability is extraordinarily broad. Companies can be held responsible for the misconduct of nearly any employee unless the motive was purely personal gain. Under current legal theory, the company will not be exonerated by specific and repeated instructions to refrain from the conduct that supports the criminal charge.

Government Policy and Legal Standards Should be Reformed. The government has learned to exploit the power conferred by this legal standard and the devastating effects of an indictment against the company. It has formulated policies that have generated a “culture of waiver” in which companies have been forced to provide extraordinary levels of cooperation to attempt to avoid a criminal charge. Often, the company now effectively conducts the investigation on behalf of the government. Moreover, when the government insists that the company must be charged, it has extracted monetary fines and penalties totaling hundreds of millions of dollars through negotiated agreements in cases that were at best questionable. Some of the largest corporate payments were made in cases where the allegedly culpable corporate representatives eventually were acquitted at trial.

The government’s extraordinary advantage should be restrained and some level of balance restored. This can be accomplished, in part, by recognizing the extent of the company’s realistic ability to control corporate conduct. Stated simply, a company does not have the ability to control absolutely the conduct of each and every one of its representatives. At best, the company can set a policy that requires full compliance with all legal and ethical requirements, it can effectively and regularly communicate that policy to its employees and it can monitor and enforce those requirements. If misconduct occurs despite these compliance efforts, there is no rational basis to hold the company criminally responsible. The company should not be punished for having done everything within its power – irrespective of whether those efforts are ultimately successful.

Neither specific nor general deterrence are advanced by a criminal proceeding despite the company’s best compliance efforts. In this context, the company has already done everything that reasonably could be expected or required. It has not ignored or attempted to avoid its responsibility. A prosecution will not promote specific deterrence because the company cannot do more than is reasonable and possible, even if the government threatens to impose criminal penalties. Similarly, general deterrence relating to the conduct of other companies actually may be undermined. Companies could rationally conclude that the expenditures necessary to implement and enforce effective compliance programs are not justified if those efforts will be ignored or given little weight in the government’s prosecutorial decision.

The government itself has recognized that the evaluation of the effectiveness of a compliance program should not depend on whether misconduct actually occurred within the company.¹ Rather, the focus should be on the company’s efforts to ensure compliance, not on whether those efforts were undermined by an employee who refused to comply with corporate policy.

The government should recognize this reality in formulating its policy for corporate criminal prosecution. The DOJ policy should insulate a company from prosecution if it operated an objectively reasonable and effective compliance program. Stated directly, a program that is properly conceived and diligently implemented should protect the company from the effects of misconduct by its representatives.

This policy would require the government to investigate the company’s compliance program at the same time that it reviewed the conduct of the company’s employees. The government investigation would be required to address another factual issue, but this is no more difficult than the inquiry needed to resolve many factual questions that must be addressed during the course of an investigation.

¹Memorandum from Larry D. Thompson, Deputy Attorney General, to heads of Department Components and United States Attorneys, Principles of Federal Prosecution of Business Organizations, VII.B (Jan. 20, 2003).

The elements necessary to establish an effective compliance program have already been defined – both in the government’s written description of prosecutorial policy, United States Attorneys’ Manual § 9-28.800 (2008), and in the Federal Sentencing Guidelines for Organizations. U.S. Sentencing Guidelines Manual § 8B2.1 (2008). The government’s investigation and evaluation would only need to determine whether the company established and operated a compliance program that conformed to these requirements.

The government has already acknowledged that the existence of a corporate compliance program is relevant to its charging decision. Under the government’s approach, however, the company’s compliance program is merely one of numerous elements to be evaluated, and there is no description of the weight to be accorded to this factor. Current policy allows the government to determine that an effective compliance program was implemented, but nevertheless to proceed with the prosecution of the company. This policy can produce the bizarre conclusion that the company should be punished criminally despite having done everything reasonably required to avoid questionable conduct.

To implement reasonable and effective reform, the crucial importance of a company’s compliance program also should be recognized by the trial court. The most direct and meaningful approach would require the government to prove that the company’s compliance program failed to meet objective standards of reasonableness and effectiveness. If the government could not carry this burden, the court should hold there was a failure to establish that the company acted with the “bad intent” necessary to prove most serious criminal charges.

Although this approach would reflect the reality of a company’s ability to control the conduct of its representatives and would help to rectify the abuse of the government’s power to pursue criminal charges, it has not been accepted by district courts. Recently, an attempt to impose this requirement was tersely rejected. *United States v. Ionia Mgmt. S.A.*, 2009 WL 116966 (2d Cir. Jan. 20, 2009).

Nevertheless, there is at least another less direct approach. Trial courts should allow companies to introduce evidence of compliance programs to counter the government’s contention that corporate representatives were operating within the scope of their duties and responsibilities. In essence, companies should be able to argue that employees who ignored corporate policy exceeded the scope of their authority, and therefore the company should not be vicariously liable for their misconduct. This approach would not result in wrongdoers escaping justice. Those employees who disregarded corporate policy and programs would be subject to prosecution. The government has long recognized that the most effective deterrence is achieved through the successful prosecution of individuals. United States Attorneys’ Manual § 9-28.100 (2008).

This limitation on corporate criminal liability would protect innocent third parties who often must bear the crippling burden of a prosecution. The enormous monetary fines that are imposed in these cases reduce the value to shareholders – owners of the company who played no part in the apparent transgressions and who might not even have owned stock in the company at the time of the misconduct. These corporate prosecutions also injure or destroy the prospects of individuals employed by the company who did not participate in or condone the improper conduct and sought to maintain a culture of legal and ethical compliance. Even the government’s expression of prosecutorial policy recognizes that a corporate indictment will adversely affect many blameless parties. *Id.*

Conclusion. The government has acquired enormous power through its ability to exploit lax legal standards to impose corporate criminal liability. It is time to restore some measure of balance. One path to that goal is to require that companies receive meaningful recognition and credit for diligent implementation of objectively reasonable compliance programs. Companies should not be held criminally responsible for conduct that their best compliance efforts were unable to prevent. Impossibility should always be a defense.