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NICK WERLE

Prosecuting Corporate Crime when Firms Are Too Big to Jail: Investigation, Deterrence, and Judicial Review

ABSTRACT. Some corporations have become so large or so systemically important that when they violate the law, the government cannot credibly threaten "efficient" criminal sanctions. By introducing political-economy constraints into a standard microeconomic model of corporate liability, this Note shows how this Too-Big-to-Jail (TBTJ) problem reduces prosecutors' ability to deter corporate crime by simply fining a defendant corporation without the accompanying prosecution of culpable individuals and mandatory structural reforms. Prosecutors often lack the ability to charge culpable individuals or enforce structural reforms. This Note further illustrates how the risk of corporate criminal liability alone cannot incentivize a TBTJ firm to invest in internal controls or cooperate with government investigations. To deter criminality by TBTJ firms, prosecutorial strategy should credibly threaten culpable managers with monetary and nonmonetary penalties and not unduly rely on corporate defendants' cooperation.

The Note also advances a structural explanation for the dearth of individual prosecutions relative to negotiated criminal settlements with TBTJ companies: prosecutors currently rely on an apparatus for investigation that may produce information necessary for corporate settlements but will not reliably produce evidence necessary to charge culpable individuals. In response, this Note proposes enlisting the courts as a bulwark against these structural incentives for prosecutors to agree to large corporate settlements without insisting on comprehensive investigation of underlying individual culpability. Thus, I propose a legislative reform that would authorize judicial review of deferred prosecution agreements to ensure prosecutors have collected sufficient evidence prior to finalizing corporate settlements.

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INTRODUCTION

Since 2000, the U.S. Department of Justice (DOJ) has prosecuted numerous companies for a range of crimes, including fraud, bribery, environmental crime, occupational safety violations, antitrust, and money laundering.[1] But relatively few of these cases have resulted in charges against culpable individuals. From 2001 to 2014, individuals faced prosecution in only 34% of the 306 cases in which federal prosecutors reached negotiated criminal settlements with corporate wrongdoers, with only 414 total individuals prosecuted.[2] Although the pace of corporate criminal settlements has increased since 2001, the proportion featuring individual prosecutions and the total number of individuals given custodial sentences have barely changed.[3]

Even when individuals are prosecuted, they are generally sentenced more leniently than defendants who faced similar charges outside of the corporate-crime context. Namely, defendants in corporate-crime cases who plead guilty or are convicted receive jail sentences less frequently and serve less jail time than do defendants facing similar charges for noncorporate crime.[4] The divergence between firm-level prosecutions and the dearth of individual prosecutions has fomented a popular narrative that the government permits managers to buy their way out of trouble, using shareholder assets to avoid individual criminal penalties by agreeing to criminal settlements.[5]

Despite this, the law-and-economics literature has suggested that government can, in some circumstances, deter corporate crime using entity liability alone.[6] Both theoretical and empirical studies treat corporate-crime control as an

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1. *See* BRANDON L. GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS 5 (2014).
2. Brandon L. Garrett, *The Corporate Criminal as Scapegoat*, 101 VA. L. REV. 1789, 1802 (2015).
3. *See id.* at 1804 tbl.1.
4. *Id.* at 1810-12 (analyzing data from the U.S. Sentencing Commission). This statistic includes all convicted defendants, including those sentenced to probation but no jail time. However, defendants in corporate-crime cases who did receive jail time had a higher average sentence than people incarcerated for other crimes in similar categories. *Id.*
5. *See, e.g.*, Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. BOOKS (Jan. 9, 2014), http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions [https://perma.cc/4GPY-JX24]; Office of Sen. Elizabeth Warren, *Rigged Justice: How Weak Enforcement Lets Corporate Offenders Off Easy*, U.S. SENATE 1 (Jan. 2016), http://www.warren.senate.gov/files/documents/Rigged_Justice_2016.pdf [https://perma.cc/6HSY-WBFD].
6. *See infra* Section II.B; *see, e.g.*, Wallace P. Mullin & Christopher M. Snyder, *Should Firms Be Allowed to Indemnify Their Employees for Sanctions?*, 26 J.L. ECON. & ORG. 30, 32 (2010) ("We

agency cost, since intrafirm information asymmetries stymie the monitoring of employees, who may engage in criminal conduct for private gain. Models of corporate crime treat this intrafirm agency problem as nested inside another agency relationship, with government seeking to deter corporate crime through a mix of incentives for corporate cooperation and punishment for wrongdoing. These standard models treat prosecutors' decisions to apportion criminal liability between companies and culpable individuals as merely discretionary choices between strategic substitutes.[7] The "optimal" punishment in the aggregate is one that forces companies and their managers to internalize the social costs of their criminal conduct. According to this theory, the government can optimize deterrence via a range of different strategies, such as (1) only prosecuting and fining corporations, (2) only prosecuting culpable individuals, or (3) adopting a mixed strategy in which prosecutors bring charges against corporations and employees. Taking DOJ policies on their face, the government has tried to prosecute both companies and individuals. DOJ employs a regime of aggressive fines, with discounts for corporate cooperation and self-reporting that purport to induce companies to invest in elaborate compliance and internal-investigation systems and to proactively disclose employee wrongdoing. According to economic theory, these threats all operate ex ante, with the risk of punishment and rewards of lawful cooperation shaping corporate practices and managerial behavior.

But does this strategy work? Does imposing large fines on corporations actually deter corporate crime?[8] Recent history suggests not. In his comprehensive 2014 study of corporate criminal prosecution, Brandon Garrett found that corporate recidivism rates remain disturbingly high.[9] He identifies as particularly troubling cases in which prosecutors find a company violating the law while subject to an active deferred prosecution agreement (DPA) — a contract that ostensibly prohibits future criminal conduct and requires ongoing cooperation with prosecutors.[10] These repeat offenses should result in sentencing enhancements

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show that deterrence can typically be obtained at minimum social cost by sanctioning the firm alone.").

7. Cindy R. Alexander, *Corporate Crime, Markets and Enforcement: A Review*, *in* NEW PERSPECTIVES ON ECONOMIC CRIME 20, 23 (Hans Sjögren & Göran Skogh eds., 2004).

8. This Note refers to "corporations" and uses the term interchangeably with "firms" and "companies." But like the Justice Manual's *Principles of Federal Prosecution of Business Organizations*, the Note's analysis "appl[ies] to the consideration of the prosecution of all types of business organizations." U.S. DEP'T OF JUSTICE, JUSTICE MANUAL § 9-28.200 n.1, https://www.justice.gov/usam [https://perma.cc/Z4R5-JCWR] [hereinafter JUSTICE MANUAL].

9. *See generally* GARRETT, *supra* note 1, at 165-68.

10. This discussion deliberately excludes nonprosecution agreements (NPAs), in which DOJ agrees not to bring any charges at all in exchange for a large payment from the corporate

when the new criminal charges are resolved, and they should prompt prosecutors to trigger breach proceedings under any existing DPAs. But this rarely happens; Garrett concludes that "[i]t is not at all clear that prosecutors take corporate recidivism seriously."[11] Indeed, the list of recidivists with multiple corporate convictions in quick succession includes industry giants such as BP, ExxonMobil, Pfizer, GlaxoSmithKline, AIG, Barclays, HSBC, JPMorgan, UBS, and Wachovia.[12]

The Too-Big-to-Jail (TBTJ) problem therefore signifies the "concern that some companies may be so valuable to the economy that prosecutors will not hold them accountable for crimes."[13] When defendant companies are so large, so systemically important, and so politically powerful that prosecutors cannot credibly threaten them with a "socially optimal" penalty, does deterrence still work? This Note contends that when firms become TBTJ, deterrence breaks down. When prosecutors set law enforcement strategy to deter crime by powerful firms, the standard economic incentives fail to adequately disincentivize criminal activity. Given this, prosecutors should modify their strategic objectives and investigative tactics to effectively manage the problem of corporate crime.

The Note presents a microeconomic model of corporate criminal prosecution in the context of TBTJ business organizations. It shows that when a defendant firm is TBTJ, prosecutors may be unable to induce it to cooperate with the government in good faith. The model also shows that there are conditions under which managers of TBTJ firms evaluating whether to engage in unlawful conduct may find criminality profitable for themselves *and* their firms. In this context, prosecutors should account for these unique political-economy constraints by encouraging third-party monitoring, rather than relying exclusively on internal corporate investigation. They should also further prioritize resolutions that mandate structural reform on companies and impose nonmonetary sanctions on culpable individuals, rather than on corporations alone.

The following hypothetical illustrates the basic TBTJ dynamic. Consider the decision-making process of managers in a global but thinly capitalized bank evaluating a highly profitable but illegal opportunity. These managers have the option to offer to an important client population a product such as an opaque cross-border transaction that facilitates income-tax evasion and laundering of drug-trafficking proceeds. Imagine further that during a recent liquidity crunch, this bank had received a government bailout because policymakers feared that—

defendant, because I propose prohibiting DOJ from entering into this kind of corporate NPA altogether. *See infra* Section VI.B.2.

11. GARRETT, *supra* note 1, at 166.

12. *Id.*

13. *Id.* at 252.

due to its size and interconnectedness—the bank's default would trigger financial contagion and destabilize the national banking system. By providing a bailout, the government impliedly announced that the bank was Too Big to Fail (TBTF). Suppose the bank managers assume that if they engage in illegal conduct, they will earn $500 million in profits, and there is only a 10% chance the government detects the transaction and prosecutes the bank. Crudely, one can say that, if convicted, the optimal fine would be $5 billion because that would make the transaction unprofitable from a cost-benefit perspective.[14] But the managers may also know that government regulators believe that a fine of $2 billion or more will catastrophically weaken the bank's balance sheet and imperil the broader financial system. In this situation, the managers may credibly conclude that the government will not intentionally damage the bank and trigger a financial crisis requiring another government bailout. That is, the managers may infer that the government is unlikely to impose a fine of more than $2 billion, regardless of the corporation's crimes.

From a coldly "rational" perspective, the managers would determine that undertaking the illegal transactions would yield a marginal profit of $500 million and incur a risk-adjusted prosecutorial fine of $200 million.[15] In this circumstance, if a corporate fine is all the bank managers really have to fear, then even from the bank's perspective this transaction with an expected profit of $300 million would be rational. And if the bank's compensation structure means the managers will get bonuses for generating the extra profit, all the more reason to break the law. Of course, this calculus only holds if the managers have no personal fear of imprisonment. Given this, prosecutors investigating this bank should not expect corporate fines alone to deter this kind of crime.

This Note's novel microeconomic model integrates the TBTJ problem into the economic analysis of corporate crime and suggests how prosecutorial strategy ought to change in response to this powerful, often binding, constraint on the government's ability to sanction a guilty company. While several similar and well-established microeconomic models of corporate criminal liability argue that it is possible to optimally deter corporate crime by sanctioning companies in some circumstances,[16] none address the political economy of the TBTJ problem.

This Note's model suggests that the government should make three strategic shifts when prosecuting crime within a TBTJ firm. First, where the government's objective is to optimally deter corporate crime, prosecutors must aggres-

14. A $5 billion fine would lead to an expected loss of $500 million from prosecution, so expected net profits would be zero.

15. ($2 billion fine) × (10% chance of prosecution) = $200 million expected loss.

16. *See infra* Section II.B.

sively charge culpable individuals within TBTJ firms. Specifically, the prosecution must induce a credible threat of nonmonetary sanctions, such as incarceration or restraints on future conduct, when individual managers and employees break the law. This conclusion reinforces DOJ's duty to follow its policy, announced in Sally Yates's September 2015 Memorandum on Individual Accountability for Corporate Wrongdoing (Yates Memo), which endorses individual prosecution to combat and deter corporate crime.[17]

Second, prosecutors negotiating with TBTJ corporate defendants should insist that any settlement mandate structural reforms. Since the TBTJ constraint means that criminal conduct may be a profitable choice for some companies, fines alone may be insufficient to induce firms to rehabilitate. But structural-reform prosecutions, formalized through DPAs, permit prosecutors to leverage criminal charges to require defendant organizations to make comprehensive institutional reforms—such as adopting internal controls, divesting problematic businesses, and redesigning products.[18] While courts will not traditionally enjoin crimes, defendant firms may agree to undertake reforms as part of the give-and-take of a settlement.[19] These requirements replace amorphous financial incentives with contractual obligations that the company must fulfill to get out from under the DPA's pending charges. In some DPAs, DOJ has required defendant companies to hire an independent compliance monitor to oversee these reforms and ensure that ongoing cooperation is in good faith. But a recent DOJ policy statement will lead the Department to reduce its use of monitorships by requiring that prosecutors engage in a cost-benefit analysis to avoid creating "unnecessary burdens to a business's operations."[20] In contrast, this Note argues that monitors are valuable tools and that a defendant company's TBTJ status should weigh in favor of imposing an independent monitor.

Third, this model finds that TBTJ companies under investigation for serious crimes may have strong disincentives to cooperate with the government in good faith. The model demonstrates that constraints on the prosecutor's ability to sanction corporate defendants make a TBTJ firm's good-faith cooperation with a government's investigation of individual wrongdoing irrational. This conclusion has substantive implications for prosecutorial strategy, since prosecutors

17. Memorandum from Sally Quillian Yates, Deputy Att'y Gen., to Assistant Att'y Gen., Antitrust Div., et al. 1 (Sept. 9, 2015), https://www.justice.gov/archives/dag/file/769036/download [https://perma.cc/S749-N82D] [hereinafter Yates Memo].

18. Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 853-54 (2007).

19. *See id.* at 874; *see also In re* Debs, 158 U.S. 564, 593 (1895).

20. Memorandum from Brian A. Benczkowski, Assistant Att'y Gen., to All Criminal Division Personnel 2 (Oct. 11, 2018), https://www.justice.gov/criminal-fraud/file/1100366/download [https://perma.cc/L8G2-GNAW].

rely heavily on corporate cooperation against employees pursuant to a DPA or as a condition of a plea deal. Indeed, full corporate cooperation against culpable individuals is a condition for any leniency under the Yates Memo.[21] However, the model shows that a defendant-funded, internal investigation is no substitute for an independent and well-resourced government investigation when firms are TBTJ.

Given this Note's finding that individual prosecutions are necessary to deter corporate crime, one might ask why there have been relatively few individual prosecutions in contrast to corporate settlements. This Note evaluates several possible explanations and concludes that the institutional apparatus used to gather evidence for corporate criminal prosecutions may exacerbate this imbalance. The current lack of binding procedure leaves the prosecutorial process vulnerable to settlements permitting a dynamic of tacit collusion. Since most "successful" cases against TBTJ companies conclude in DPAs and those settlements receive no meaningful judicial scrutiny, prosecutors can reap the political benefits of corporate prosecution without pushing an investigation to the point at which it develops evidence that inculpates individual managers. To address this structural weakness, the Note proposes legislation that would reform DPA practice. By expressly authorizing substantive judicial review of DPAs and prohibiting other negotiated settlements that bypass court approval, the DPA Procedures Act would strengthen the accountability and effectiveness of DOJ's management of corporate crime.

The Note begins in Part I by analyzing the political economy of the TBTJ problem. Part II describes the legal and economic framework within which prosecutors set corporate criminal enforcement strategy. Part III then presents the formal microeconomic model. This model plays a central role in the Note's analysis of corporate criminal prosecution, but algebra-averse readers may ignore the microeconomic details and still follow the legal and policy arguments. The Note then returns to law and policy, drawing conclusions from the economic model. Part IV shows how, when a firm becomes TBTJ, it may lack the incentive to cooperate with prosecutors in good faith. Part V then draws lessons for prosecutorial strategy. It argues that effective deterrence of corporate crime by TBTJ firms requires culpable managers to perceive a credible threat of prosecution for unlawful conduct. The Part further argues that prosecutors should rely less on the results of internal investigations conducted by TBTJ defendants and should insist that settlements include enforceable mandates for structural reform. Part VI proposes a package of legislative reforms to improve prosecutorial strategy in cases involving TBTJ defendants. Section VI.A provides a structural explanation for the relative rarity of individual prosecutions in connection with settlements

21. *See infra* Part V.

by TBTJ firms. Section VI.B then proposes legislative and administrative reforms to enhance corporate criminal prosecutions, drawing on the economic incentives illuminated by the model.[22]

I. THE TOO-BIG-TO-JAIL PROBLEM

The most familiar type of TBTJ company is a financial institution that has proven to be TBTF by virtue of having received a past government bailout or having been designated as a systemically important financial institution. When a firm knows that the government considers it TBTJ, prosecutors are constrained in their ability to deter criminal conduct.

The government acknowledges that a defendant company is TBTJ when the firm's potential failure or incapacitation is so politically untenable that prosecutors must reduce the severity of sanctions for criminal activity. Once regulators have hinted that they will backstop a bank's fiscal health, prosecutors cannot credibly threaten sanctions so severe that they would leave it with insufficient capital or imperil necessary licenses. Indeed, since the 2008 financial crisis, bailed-out Wall Street institutions have routinely settled serious criminal charges on terms that protect their profitability, and their executives continue to escape responsibility for allegedly fraudulent conduct.[23]

Public criticism of this pattern came to a head in March 2013, when the Senate Judiciary Committee conducted hearings on DOJ's recent DPA with the global bank HSBC for facilitating money laundering by Mexican drug cartels and similar organizations. Despite the lurid details, the bank was fined $1.92 billion and no individuals were prosecuted.[24] Asked whether some companies are

22. The text of the proposed statute, the DPA Procedures Act, appears in Appendix B.

23. *See, e.g.*, Jesse Eisinger, *Why Only One Top Banker Went to Jail for the Financial Crisis*, N.Y. TIMES MAG. (Apr. 30, 2014), http://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-crisis.html [https://perma.cc/X7UU-SR26]; Rakoff, *supra* note 5; Matt Taibbi, *Gangster Bankers: Too Big to Jail*, ROLLING STONE (Feb. 14, 2013), http://www.rollingstone.com/politics/news/gangster-bankers-too-big-to-jail-20130214 [https://perma.cc/8ZPD-K27P]; Jason M. Breslow, *Ted Kaufman: Wall Street Prosecutions Never Made a Priority*, PBS: FRONTLINE (Jan. 22, 2013), http://www.pbs.org/wgbh/frontline/article/ted-kaufman-wall-street-prosecutions-never-made-a-priority [https://perma.cc/5HXY-WHZD]; Bartlett Collins Naylor, *Too Big: The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage*, PUB. CITIZEN (2016), http://www.citizen.org/documents/TooBig.pdf [https://perma.cc/PNL5-73B8].

24. *See* Ben Protess & Jessica Silver-Greenberg, *HSBC to Pay $1.92 Billion to Settle Charges of Money Laundering*, N.Y. TIMES: DEALBOOK (Dec. 10, 2012, 4:10 PM), http://dealbook.nytimes.com/2012/12/10/hsbc-said-to-near-1-9-billion-settlement-over-money-laundering [https://perma.cc/J8CN-PVAC]; *see also* Dominic Rushe & Jill Treanor, *HSBC's Record $1.9bn Fine*

TBTJ, Attorney General Eric Holder acknowledged that the threat of economic distress constrains DOJ prosecutors investigating global banks' crimes:

> I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if we do prosecute—if we do bring a criminal charge—it will have a negative impact on the national economy, perhaps even the world economy. I think that is a function of the fact that some of these institutions have become too large . . . . I think it has an inhibiting influence, impact on our ability to bring resolutions that I think would be more appropriate.[25]

Holder's comments echoed those made by Lanny Breuer, head of DOJ's Criminal Division in the wake of the financial crisis, who confirmed that prosecutors regularly consult regulators regarding the systemic implications of their cases and change their strategies when "as a result of bringing [a] case there's some huge economic effect."[26] Corporate criminal penalties may be large in absolute terms, but Garrett's analysis of settlement data shows that companies almost always receive fines at or below the range suggested by the federal Sentencing Commission's Organizational Sentencing Guidelines.[27]

In many cases, companies mobilize economic and political power to enlist foreign government entities in pushing the TBTJ argument. For instance, in the HSBC case, the UK Financial Services Authority and UK Chancellor George Osborne intervened to help the UK-regulated bank avoid criminal charges.[28] Similarly, during negotiations between DOJ and French bank BNP Paribas, which

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Preferable to Prosecution, U.S. Authorities Insist, GUARDIAN (Dec. 11, 2012, 3:37 PM), https://www.theguardian.com/business/2012/dec/11/hsbc-fine-prosecution-money-laundering [https://perma.cc/TM2T-M523] (referencing DOJ officials who argued that the fine and DPA were preferable to the "collateral consequences" of taking the bank to court on money laundering charges or revoking its U.S. banking license).

25. *Hearing Before the S. Comm. on the Judiciary*, 113th Cong. (Mar. 6, 2013), http://www.judiciary.senate.gov/meetings/oversight-of-the-us-department-of-justice-2013-03-06 [https://perma.cc/JK8C-JYWC] (statement of Eric Holder, Att'y Gen. of the United States).

26. Jason M. Breslow, *Lanny Breuer: Financial Fraud Has Not Gone Unpunished*, PBS: FRONTLINE (Jan. 22, 2013), http://www.pbs.org/wgbh/frontline/article/lanny-breuer-financial-fraud-has-not-gone-unpunished [https://perma.cc/P4WX-8KN3].

27. GARRETT, *supra* note 1, at 150 (noting that, in an analysis of 255 settlements between 2011 and 2012, "[a]lmost without exception, [prosecutors] explained that the fine was at or below the very bottom of the guidelines range, even for cases involving large public companies. Only three agreements noted fines at the top of the range").

28. *See* Ben McLannahan, *Osborne Intervened in U.S. HSBC Money-Laundering Probe, Report Says*, FIN. TIMES (July 12, 2016), https://www.ft.com/content/2be49f84-47c9-11e6-b387-64ab0a had helped clients evade U.S. sanctions, both BNP's CEO and the Governor of the Bank of France met with American authorities to ask for leniency. They argued that the guilty plea and fine proposed by prosecutors would dangerously erode BNP's capital levels.[29] French authorities, from the Finance Minister to the President, made on-the-record warnings that such a hit to BNP's balance sheet could substantially restrict credit in the struggling national economy, possibly requiring a bailout.[30] French officials also reportedly argued that any limitation on the bank's ability to make U.S.-dollar transactions—the very business at issue in the sanctions violations—"could spark a systemic crisis, endangering the wider financial system."[31] BNP Paribas ultimately pled guilty and paid $8.9 billion, but no individuals were prosecuted.[32] Although that fine was the highest ever for a sanctions case, an analysis by the *Wall Street Journal* showed that negotiations may have resulted in a substantial discount: Scottish bank RBS paid over ten times more in fines per dollar of allegedly illegal transactions than did BNP.[33] Indeed, data from the capital markets suggest that BNP's fine could have been much worse.[34]

The TBTJ classification does not include a fixed membership nor is inclusion the result of objective economic analysis. Designating a firm as TBTJ is a political choice that operates before, during, and after each major corporate prosecution,

67014c [https://perma.cc/WW7M-CXAQ]; *see also* Republican Staff, U.S. House of Representatives Committee on Financial Services, *Too Big to Jail: Inside the Obama Justice Department's Decision Not to Hold Wall Street Accountable*, U.S. HOUSE REPRESENTATIVES 43 (July 11, 2016), https://financialservices.house.gov/uploadedfiles/07072016_oi_tbtj_sr.pdf [https://perma.cc/KSJ4-U857].

29. Jessica Silver-Greenberg & Ben Protess, *BNP Paribas Pinned Hopes on Legal Memo, in Vain*, N.Y. TIMES: DEALBOOK (June 3, 2014, 9:11 PM), http://dealbook.nytimes.com/2014/06/03/bnp-paribas-pinned-hopes-on-legal-memo-in-vain [https://perma.cc/9FH6-665T].

30. William Horobin, *France Claims Victory in BNP Paribas Case*, WALL ST. J. (July 1, 2014, 6:38 AM), http://www.wsj.com/articles/france-claims-victory-in-bnp-paribas-case-1404211120 [https://perma.cc/8NBX-DD44].

31. *Id.*

32. *See* Devlin Barrett et al., *BNP Paribas Draws Record Fine for "Tour de Fraud,"* WALL ST. J. (June 30, 2014), http://www.wsj.com/articles/bnp-agrees-to-pay-over-8-8-billion-to-settle-sanctions-probe-1404160117 [https://perma.cc/M6HF-PJZC] ("Justice Department officials said the bank's unwillingness to come clean earlier made it difficult to charge any individuals.").

33. *See id.* (calculating that RBS paid $3.13 for every $1 of alleged violations, Standard Chartered paid $1, Credit Suisse paid $0.45, and BNP Paribas paid $0.27-0.30).

34. Horobin, *supra* note 30 ("Investors agreed the damage limitation mission was successful: BNP Paribas shares jumped over 3% in Tuesday morning trading [just after the fine was announced].").

not an objective conclusion from a set of static criteria. In other contexts, companies object to inclusion on lists of TBTF institutions because the designation can increase costs and regulatory scrutiny.[35] But in closed-door negotiations with prosecutors considering criminal charges or a punitive settlement, powerful companies often argue, directly or through proxies, that harsh punishment would cause economic devastation.[36] Although the decision to cap a firm's punishment is hashed out on a case-by-case basis, many defendants are recidivists, and virtually all regularly engage with other governmental actors, either as government contractors or as objects of regulatory supervision. Such repeat players can reliably predict ex ante whether they are regarded as TBTF, and will therefore evade otherwise-appropriate penalties for criminal behavior. Thus, designation as a TBTJ firm is not a juridical or administrative categorization but a measure of political-economic power.

No case has influenced DOJ's corporate-crime strategy more than its prosecution of "Big Five" accounting firm Arthur Andersen LLP for its role in the Enron debacle.[37] Following conviction at trial in June 2002, the SEC prohibited Andersen from auditing public companies—previously the core of its business. The firm collapsed two months later, throwing thousands of workers out of their jobs and further consolidating the systemically important industry of auditing public companies.[38] Worst of all, the Supreme Court unanimously reversed the entity's conviction in 2005 due to faulty jury instructions.[39] But this appellate victory neither restored lost jobs nor reversed the accounting industry's further consolidation.

Following the Andersen episode, DOJ changed policy to consider a corporate conviction's collateral consequences in its charging strategy.[40] The result was a

35. *See, e.g.*, Metlife v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219 (D.D.C. 2016).

36. *See, e.g.*, *U.S. Fine on Deutsche Bank Too Big, Damaging to Stability: Dijsselbloem*, REUTERS (Oct. 7, 2016), http://www.reuters.com/article/us-germany-deutsche-bank-dijsselbloem-idUSKCN1271OE [https://perma.cc/6LUA-CQ47] (describing how the President of the Board of Governors of the European Stability Mechanism warned DOJ that a $14 billion fine for Deutsch Bank's fraudulent marketing of faulty mortgage bonds before the financial crisis would destabilize the European financial system).

37. *See* GARRETT, *supra* note 1, at 12 (describing the Arthur Andersen prosecution as "[t]he corporate trial of the century"); Gabriel Markoff, *Arthur Andersen and the Myth of the Corporate Death Penalty: Corporate Criminal Convictions in the Twenty-First Century*, 15 U. PA. J. BUS. L. 797 (2013).

38. GARRETT, *supra* note 1, at 40-41.

39. *See* Arthur Andersen LLP v. United States, 544 U.S. 696 (2005).

40. *See* Memorandum from Larry Thompson, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Attorneys (Jan. 20, 2003), https://www.americanbar.org/content/dam/aba/migrated/poladv/priorities/privilegewaiver/2003jan20_privwaiv_dojthomp decision-making framework that encouraged prosecutors to negotiate DPAs and extend leniency to companies willing to cooperate with DOJ investigations.[41] The policy aimed to prevent collateral consequences from harming people dependent on the corporation but uninvolved in its misconduct. Structuring negotiated settlements to avoid the specter of a "corporate death penalty" means, in practice, maintaining the business as a financially healthy, going concern.[42] Of course, all criminal convictions generate harmful collateral consequences, such as deportation, loss of public benefits, labor-market exclusion, and familial trauma for defendants and their innocent dependents. But the strategic implications of a conviction's collateral consequences depend on its political-economy context: individual convictions rarely produce systemic risk, layoffs, or permanent shareholder losses, so there is no formal mechanism for capping those collateral consequences.

The TBTJ problem is not restricted to the financial sector. In cases against nonfinancial companies, size, systemic importance, and political power have compelled government authorities to impose lesser penalties. For instance, the government has been reluctant to indict any of the remaining Big Four accounting firms, given their nodal position in regulating securities markets.[43] There are other industries where government contracting is essential, so prosecutors are careful to avoid penalties leading to automatic debarments that would imperil government operations. This is common with respect to defense and intelligence

.authcheckdam.pdf [https://perma.cc/BQ3D-V3WP]; *see also* JUSTICE MANUAL, *supra* note 8, § 9-28.1100.

41. *See* GARRETT, *supra* note 1, at 6-7.

42. *Id.* at 14-16.

43. *See id.* at 67-68 (discussing DOJ's decision in 2006 not to suspend KPMG from its contract to audit DOJ's own books following a settlement for selling illegal tax shelters); TANINA ROSTAIN & MILTON C. REGAN, JR., CONFIDENCE GAMES: LAWYERS, ACCOUNTANTS, AND THE TAX SHELTER INDUSTRY 309-17 (2014) (describing KPMG's strategy in negotiating with DOJ as arguing that indicting the firm would lead to its collapse and that "the Big Four were 'too few' for KPMG to be allowed to fail"); *see also* Materials on Nonprosecution Agreement Between the Southern District of New York and Ernst & Young LLP, http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/EY.pdf [https://perma.cc/4ZV4-3F8K].

contractors,[44] aerospace,[45] energy,[46] and logistics.[47] Other companies, such as auto manufacturers, may be such large employers or wholesalers that it would be politically and economically harmful for prosecutors' sanctions to damage their finances.[48] Finally, some companies may be regarded as systemically important because they provide unique infrastructure services to telecommunications networks or financial markets.[49] Thus, the term TBTJ really represents any company the government deems too important or powerful to jail.

44. *See, e.g.*, Materials on Nonprosecution Agreement Between the U.S. Department of Justice, Criminal Division, Fraud Section, and Textron Inc., http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/textron.pdf [https://perma.cc/BP3R-J63M].

45. *See, e.g.*, Materials on Nonprosecution Agreement Between the Eastern District of Virginia, Central District of California, and Boeing Co., http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/boeing.pdf [https://perma.cc/YS38-8DNR] (discussing federal contracting fraud against the U.S. Air Force and NASA).

46. *See, e.g.*, Materials on Nonprosecution Agreement Between the Southern District of New York and Chevron Corp., http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/chevron.pdf [https://perma.cc/4J87-PZLF] (discussing fraud in the Iraqi oil-for-food program).

47. *See, e.g.*, Materials on Nonprosecution Agreement Between the Northern District of California and UPS, Inc., http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/UPS.pdf [https://perma.cc/J6GJ-5KMQ] (discussing the illegal distribution of controlled substances).

48. *See, e.g.*, Materials on Nonprosecution Agreement Between the Southern District of New York and General Motors Co., http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/gm.pdf [https://perma.cc/B299-3KNL].

49. *See* Rena Steinzor & Anne Havemann, *Too Big to Obey: Why BP Should Be Debarred*, 36 WM. & MARY ENVTL. L. & POL'Y REV. 81, 111 (2011) (describing how "large corporations with long records of misconduct have escaped debarment" and arguing that "the [Department of Defense] has persuaded itself that its major contractors are simply too big to debar"); Drury D. Stevenson & Nicholas J. Wagoner, *FCPA Sanctions: Too Big to Debar?*, 80 FORDHAM L. REV. 775, 809-11 (2011) (describing how the federal government is too reliant on many large companies guilty of Foreign Corrupt Practices Act (FCPA) violations to enforce a debarment); Scott H. Amey, *Federal Contractor Misconduct: Failures of the Suspension and Debarment System*, PROJECT ON GOV'T OVERSIGHT (May 10, 2002), http://www.pogo.org/our-work/reports/2002/co-fcm-20020510.html [https://perma.cc/9U9A-XBWC]. *See generally* GARRETT, *supra* note 1, at 255 (discussing the TBTJ problem beyond the financial industry).

II. CORPORATE CRIMINAL LIABILITY

A. Legal Constraints

This Note focuses on prosecutorial strategy rather than judicial doctrine. As resolving corporate-crime prosecutions through negotiated settlements has become normal, fewer cases are fully litigated. Consequently, negotiations take place in the shadow of the law, constrained more by nonbinding DOJ guidance and the practices of repeat players than by doctrine. Nevertheless, doctrine does present some constraints: at least one individual must be theoretically liable for a corporate criminal prosecution to proceed.

Under federal criminal law, corporate criminal liability rests on the doctrine of respondeat superior[50]: a company's criminal liability derives entirely from individuals' actions and mental states, since "a corporation can act only through individuals."[51] The Justice Manual lays out the applicable test for corporate criminal liability:

> Under the doctrine of respondeat superior, a corporation may be held criminally liable for certain illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent's actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation.[52]

Federal law is strict—a company is theoretically liable for the criminal acts of *any* employee. And because corporate criminal liability can only arise from individual criminal conduct, the presence of a corporation's criminal prosecution suggests that some individual is liable too.

Of course, this does not mean individuals will always be charged. Prosecutorial discretion lies at the core of the executive branch's constitutional authority to determine law enforcement strategy.[53] In deciding whether and how to proceed with charges, the executive branch weighs various policy considerations, including economic consequences.[54] This discretion includes the decision

50. *See* N.Y. Cent. & Hudson River R.R. v. United States, 212 U.S. 481, 493-95 (1909).

51. JUSTICE MANUAL, *supra* note 8, § 9-28.210.

52. *Id.*

53. *See* United States v. Batchelder, 442 U.S. 114, 124 (1979).

54. *Cf.* Morrison v. Olson, 487 U.S. 654, 708 (1988) (Scalia, J., dissenting) ("[T]he balancing of various legal, practical, and political considerations, none of which is absolute, is the very essence of prosecutorial discretion.").

whether to criminally charge a company, culpable individuals, both, or neither.[55] DOJ regulates charging discretion with the Justice Manual's Principles of Federal Prosecution of Business Organizations, which describe the legal and policy concerns prosecutors should consider.[56] And while courts can dismiss improper charges, the judiciary can neither introduce alternative charges nor compel the government to charge unindicted parties.[57]

B. Microeconomics

Gary Becker's classic study of crime as a rational choice inaugurated the economic analysis of criminal deterrence.[58] Deterrence theory assumes an individual will commit an unlawful act if the expected private benefit is greater than the expected disutility of any sanctions. Under Becker's model, the government should adopt a law enforcement policy that yields an expected penalty sufficient to force individuals to internalize the social costs of their behavior. Thus, crime is an agency cost of the divergence between the interests of the corporate criminal and society.

The economic literature draws two policy conclusions. First, policy makers can achieve any given level of deterrence by trading off the severity of punishment with the probability of conviction. Enforcement is costly, so Becker argues that under certain assumptions, optimal policy imposes maximal punishment to reduce law enforcement costs.[59] This resolution to the certainty/severity tradeoff—minimal enforcement with maximal fines—has engendered a literature analyzing how law enforcement regimes based on random crackdowns or self-reporting might increase policing efficiency.[60] Using differential sanctions structures to induce defendants to fund internal investigations for prosecutors' benefit is an extension of this efficiency-driven strategy.

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55. *See* United States v. Fokker Servs. B.V., 818 F.3d 733, 746 (D.C. Cir. 2016) (reversing a district court's refusal to approve a DPA with a corporate defendant in part because no individuals were charged).

56. *See* JUSTICE MANUAL, *supra* note 8, § 9-28.200.

57. *See* Wayte v. United States, 470 U.S. 598, 607-08 (1985); Bordenkircher v. Hayes, 434 U.S. 357, 364 (1978).

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

59. *Id.* at 183-84.

60. *See, e.g.*, Jan Eeckhout et al., *A Theory of Optimal Random Crackdowns*, 100 AM. ECON. REV. 1104 (2010).

Second, fines are the preferred sanction because they are socially costless transfer payments, while incarceration imposes social costs.[61] This conclusion assumes that all punishments have a monetary equivalent, so prison is reserved for people unable to pay the socially necessary fines. Richard Posner agrees, arguing that white-collar criminals should be subject to fines instead of incarceration, so long as they can pay.[62] However, John C. Coffee argues that if a monetary equivalent to incarceration even exists in a meaningful sense, it is impossible to measure.[63] Further, he argues that the white-collar criminal's psychological response to incarceration is such that society could achieve significant deterrence even from short sentences. If this psychological response to incarceration is frontloaded, then draconian sentences are dispensable. Rather than threatening longer sentences, Coffee's critique suggests that increasing the likelihood of prosecution optimally deters white-collar crime.

Subsequent law-and-economics scholarship has extended Becker's framework to analyze corporate crime.[64] These game-theoretic models use a principal-agent structure first applied to vicarious tort liability to explore how criminal liability ought to be distributed between firms and their employees.[65] These agency models posit shareholder-principals trying to elicit profit-maximizing management strategies from employee-agents.[66] The basic setup posits a principal, who seeks to achieve a particular outcome through the actions of a discrete agent, who chooses rationally how much effort to exert. Microeconomists analyze agency as a nested optimization problem: the principal chooses a contract that will motivate the agent to act as the principal wishes, while the information asymmetry between them introduces transaction costs.

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61. Richard A. Posner, *Optimal Sentences for White-Collar Criminals*, 17 AM. CRIM. L. REV. 409, 410 (1980).

62. *Id.* at 415 ("For every prison sentence there is some fine equivalent; if the fine is so large that it cannot be collected, then the offender should be imprisoned.").

63. John Collins Coffee, Jr., *Corporate Crime and Punishment: A Non-Chicago View of the Economics of Criminal Sanctions*, 17 AM. CRIM. L. REV. 419, 425 (1980).

64. *See, e.g.*, Nuno Garoupa, *Corporate Criminal Law and Organization Incentives: A Managerial Perspective*, 21 MANAGERIAL & DECISION ECON. 243, 243-44 (2000); A. Mitchell Polinsky & Steven Shavell, *Should Employees Be Subject to Fines and Imprisonment Given the Existence of Corporate Liability?*, 13 INT'L REV. L. ECON. 239 (1993).

65. *See, e.g.*, Alan O. Sykes, *The Economics of Vicarious Liability*, 93 YALE L.J. 1231 (1984).

66. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (drawing on theories of agency, property rights, and finance to develop a theory of ownership structure for the firm). *But see* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) (critiquing the agency-theoretic model of the corporation).

In the corporate-crime context, there are three nested agency relationships. First, the manager acts as the agent of the corporation, which sets incentives through compensation and disciplinary rules. Second, the corporation acts as an agent of the government: prosecutors, acting as principals, aim to ensure compliance with the law while facilitating a legal regime conducive to lawful business. Thus, the prosecutor's choice of enforcement policy will create incentives for the corporation as agent, which in turn structures employee incentives. And third, the manager interacts under an agency relationship directly with prosecutors, who seek to deter criminal conduct by threatening individual prosecution.

Much of the law-and-economics literature has argued that crime within a corporation is an agency cost, arising from an employee acting against the corporation's interest by substituting malfeasance for honest performance.[67] Thus, the agency view is less useful for understanding "control frauds"—a term coined by William Black to describe situations in which a controller or other insider uses the corporate form as an instrumentality of his criminal malfeasance, setting up or operating the company to achieve an unlawful purpose such as tax evasion, smuggling, or fraud.[68] Econometric evidence supports the theoretical literature's contention that crime in publicly traded corporations is, at least in part, an agency cost.[69]

If there is consensus among law-and-economics scholars, it is that no single optimal mix of criminal liability for individual employees and vicarious liability exists for business organizations.[70] Many analyses assume individuals will be held accountable and then ask when, if ever, vicarious corporate liability is warranted. Scholars have supported vicarious liability when the employer can monitor employee wrongdoing more efficiently than the government can or when individual employees are unable to pay the optimal fines.[71] Scholars and policy makers chiefly justify corporate criminal liability by arguing that penalties force companies to internalize the costs of criminality and so provide an incentive to invest in compliance operations and internal controls. Jennifer Arlen and Reinier

67. *See, e.g.*, 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, 1-4 (1999); Jonathan R. Macey, *Agency Theory and the Criminal Liability of Organizations*, 71 B.U. L. REV. 315, 334 (1991).

68. WILLIAM K. BLACK, THE BEST WAY TO ROB A BANK IS TO OWN ONE: HOW CORPORATE EXECUTIVES AND POLITICIANS LOOTED THE S&L INDUSTRY 1-6 (2d ed. 2014).

69. Alexander & Cohen, *supra* note 67, at 2 (finding that empirical analysis supports the hypothesis that corporate crime reflects an intrafirm agency cost).

70. *See, e.g.*, Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 694 (1997).

71. *See* Alexander, *supra* note 7, at 23-24; Lewis A. Kornhauser, *An Economic Analysis of the Choice Between Enterprise and Personal Liability for Accidents*, 70 CALIF. L. REV. 1345, 1362-66 (1982).

Kraakman have found that corporate liability, if properly structured, may encourage companies to develop costly internal controls.[72] In general, when it finds corporate liability justified, the law-and-economics literature expresses a preference for penalties that do not impose substantive mandates for internal reform.[73]

But corporate liability has also been called counterproductive. For instance, Jonathan Macey contends that vicarious corporate criminal liability creates real social costs because penalizing shareholders through vicarious liability discourages already risk-averse managers from acting even when the benefits outweigh the costs. Macey argues that managers' self-interest makes them more risk averse than shareholders and concludes that "[i]n large, publicly held corporations, it seems highly implausible that managers are selected on the basis of their willingness to engage in criminal activity."[74] Others contend that "subjecting business entities to criminal liability carrying severe collateral consequences might, in fact, undermine deterrence" and that "purely financial penalties could contain misconduct more effectively than the threat of going out of business."[75]

Since large companies face penalties more frequently than their culpable individual employees do, the strategic question is more properly reversed: given corporate liability, when should prosecutors pursue individual charges? Some believe that "an enforcement strategy of only imposing sanctions on shareholders can be sufficient in some instances."[76] Or as one study put it, "deterrence can typically be obtained at minimum social cost by sanctioning the firm alone."[77]

Nevertheless, the literature does consider individual liability to be important in certain circumstances. When incarceration is necessary for deterrence,[78] when a company is unable to effectively monitor or discipline its employees,[79] and when the government seeks to pressure employees to cooperate against the firm,[80] individual liability can be an essential tool.

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72. Arlen & Kraakman, *supra* note 70, at 730-35 (describing how composite liability regimes may incentivize efficient internal policing).

73. *See, e.g.*, Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation Through Nonprosecution*, 84 U. CHI. L. REV. 323, 325, 352-53 (2017).

74. *See* Macey, *supra* note 67, at 325.

75. Assaf Hamdani & Alon Klement, *Corporate Crime and Deterrence*, 61 STAN. L. REV. 271, 274 (2008).

76. Alexander, *supra* note 7, at 33.

77. Mullin & Snyder, *supra* note 6, at 32.

78. *See id.* at 41.

79. *Id.*; *see also* Polinsky & Shavell, *supra* note 64, at 240-41.

80. Mullin & Snyder, *supra* note 6, at 40.

Beyond the question of individual liability, the literature has not contended with the question of whether a large firm's political and economic power should alter prosecutorial strategy. Some scholars have tried to assume away the problem: Macey, for example, has argued that corporate crime should be more common in smaller firms than in large ones, because managers in smaller firms can capture a larger share of the profits gained by criminal activities.[81] Jennifer Arlen and Marcel Kahan have recognized that publicly held companies may have governance structures that increase policing agency costs, and so ought to be subject to greater mandates for internal reform, but their analysis is unconnected to political or economic power.[82] Some analytic models of corporate criminal liability expressly or implicitly assume that firms have unlimited liability.[83] It is a familiar result that where one party in a principal-agent relationship is judgment proof, criminal deterrence may only be possible by sanctioning the other party.[84] But the TBTJ problem diverges from this analysis because, unlike a judgment-proof company, the TBTJ firm survives its sanction as a fiscally sound, going concern. This Note is thus the first to consider how firm power and market concentration alter the analysis of corporate criminal liability.

The microeconomic model that forms this Note's analytical core is based on one developed by Nuno Garoupa.[85] Garoupa begins with individual liability and asks whether corporate liability should be imposed at all.[86] His model starts with a manager whose effort exertion is unobservable to the firm and costly to the manager but who can also choose to exert some amount of socially harmful effort that produces a private benefit. Garoupa argues that individual fines are more efficient than corporate fines because the latter distort intrafirm incentives at the cost of productive efficiency. Thus, he argues that corporate liability is only efficient when an employee has insufficient wealth to internalize the costs of crime. He acknowledges that nonmonetary sanctions on individuals can be a partial source of deterrence, but he dismisses them as overly expensive.[87] Garoupa also

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81. Macey, *supra* note 67, at 323-24.

82. Arlen & Kahan, *supra* note 73, at 353-55.

83. *See, e.g.*, Mullin & Snyder, *supra* note 6, at 41-42.

84. *Id.* at 42; Steven Shavell, *The Judgment Proof Problem*, 6 INT'L REV. L. & ECON. 45, 45 (1986).

85. *See* Garoupa, *supra* note 64, at 245.

86. *Id*. at 244 ("In a perfect world . . . individual liability alone would induce efficient behavior. Consequently, corporate liability would not be necessary. Conversely, corporate liability is worthwhile investigating when contracts are incomplete or when solvency matters." (citation omitted)).

87. *Id.* ("Imposing non-monetary sanctions (e.g. imprisonment sentences) is a partial solution to the problem of agents' insufficient wealth. Imprisonment, however, is expensive and usually shows that when firms are subject to corporate liability, they can reduce the resulting intrafirm incentive distortion by funding internal-control mechanisms, such as corporate compliance departments. He therefore concludes law enforcement policy can always elicit corporate cooperation with government investigations so long as firms receive a discount for self-reporting individual criminal activity.[88]

This Note incorporates several new features into the Garoupa model. First, it adds a constraint to represent situations when the defendant firm is TBTJ. The core contribution of this Note's model is explaining how a TBTJ constraint alters the optimal law enforcement strategy relative to Garoupa's baseline. Second, this Note introduces the possibility of punishing culpable individuals with nonmonetary sanctions. The strategic importance of credibly threatening culpable individuals with incarceration or nonmonetary sanctions arises when defendant firms become TBTJ.

III. THE ECONOMIC MODEL: TOO-BIG-TO-JAIL PROSECUTION

The high concentration of many economic sectors and the profusion of large, politically powerful firms have led the TBTJ problem to dominate corporate criminal prosecutors' decision-making. Yet the law-and-economics literature on corporate criminal liability has not considered the strategic implications of the TBTJ constraint. This Part adapts Garoupa's game-theoretic model of corporate criminal liability, introducing a TBTJ constraint and evaluating the deterrence achieved by various prosecutorial strategies.[89] This new model shows that when a firm becomes TBTJ, it can expect to profit from certain crimes even when it may confront corporate prosecution. Thus, the firm may lack incentive to cooperate with government investigations in good faith. Given this, prosecutors seeking to deter corporate crime by TBTJ firms should adjust their strategies to rely less heavily on internal investigations, to focus more intently on charging culpable individuals, and to insist that guilty corporations adopt structural-reform provisions in negotiated settlements.

The model considers a hypothetical prosecutor pursuing criminal charges against a corporation and a culpable manager for criminal conduct that resulted from the manager's choice to exert effort in an antisocial but profitable direction.

courts are not willing to impose it. Thus, corporate liability is the other possible solution." (citation omitted)).

88. *Id.* at 249-50; *see also* Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 835-36 (1994) (describing the conditions under which corporate criminal liability elicits firms' cooperation with the government).

89. *See* Garoupa, *supra* note 64, at 245-46.

The manager makes this choice rationally with respect to the incentives laid before him. The model permits the prosecutor to pursue three types of sanctions: (1) fining the company; (2) fining the manager; or (3) imposing a nonmonetary penalty on the manager, such as incarceration, an industry ban, or a set of restorative-justice requirements. The TBTJ constraint is represented by an upper limit on the corporate fine that the prosecutor may impose, reflecting the background political economy. The firm can choose to police its employees by investing in an internal compliance department, which would "cooperate" with the government by reporting employee wrongdoing to the prosecutor. The prosecutor can in turn encourage the firm to do so by giving the firm "cooperation credit"—that is, a discount on the corporate fine for voluntarily disclosed individual criminal conduct.

After defining the model's game-theoretic structure in Section III.A, I present the model in three stages, adding new complications at each step. Section III.B considers a circumstance without any information asymmetry within the firm. That is, the manager cannot hide his actions from the corporation, which can specify exactly how the manager should act. This analysis shows why TBTJ corporations may find criminality profitable when the prosecutor does not credibly threaten the manager with nonmonetary sanctions. (Additional details underlying the derivation appear in Appendix A.1, the mathematical appendix.)

Second, Section III.C discusses the implications of information asymmetry within the firm, where the manager can hide his actions and the corporation cannot specify exactly how he should work. This is a stepping stone to the full model. (Mathematical details are worked out in Appendix A.2.)

Finally, Section III.D presents the full model. Here, the corporation may choose to invest in a costly system of internal controls, such as a compliance department. When these internal controls detect wrongdoing by the manager, the firm will report it to the government. While self-reporting employee crime may subject the firm to prosecution, the government incentivizes self-reporting behavior by giving the firm a "discount" on its fine relative to the fine imposed if the government detects the wrongdoing independently.

Parts IV and V proceed to draw conclusions and strategic implications from the model. In brief, these Parts show that when a firm becomes TBTJ, the government may be unable to effectively induce the firm to cooperate with prosecutors in good faith. Algebra-averse readers solely interested in the model's legal and policy implications may skip to Part VI without losing the argument's thread.

A. *Outline of the Law Enforcement Game*

This Note's model adopts the same basic setup from Garoupa's original paper.[90] It posits three actors—the government, a risk-neutral firm, and a risk-neutral manager—as players in a sequential, one-period game. The manager exerts two forms of effort: one that is productive for the firm and socially acceptable (m) and another that is profitable for the manager, socially harmful, and illegal (n). Exerting socially harmful effort raises the risk that some damage is realized. When the manager engages in the illegal conduct and the damage materializes, he has satisfied the elements of a crime. That is, the manager can be convicted of a crime if and only if he caused the unlawful event to occur. The model describes a regime of strict, vicarious liability, in which the manager's guilt is directly and necessarily imputed to his employer. As with federal criminal law's respondeat superior rule, the firm is criminally liable if and only if the manager is.

The game initially proceeds in the following order:

1. The government "announces" a criminal justice policy, which is public knowledge. The policy includes several parameters. First, the government institutes a level of costly investigation and enforcement to detect, convict, and punish with a probability σ, conditional on a crime having been committed. Second, the government chooses to impose a fine of S_f on the firm if the manager is caught committing a crime.[91] Third, it chooses sanctions to impose on the manager if he is caught and prosecuted. This could include a fine S_m and a period of incarceration π. As noted earlier, the law enforcement policy can include any mix of individual and corporate sanctions, including no sanction for one party if the prosecutor decides to indict one but not the other. However, the prosecutor's choice is constrained by the defendants' ability to pay: the manager has maximum recoverable wealth of $\overline{W}$ and, if the firm is TBTJ, then it can be made to pay no more than ξ.
2. The firm offers the manager a contract that pays a fixed wage ω and a share μ of total revenue. As discussed in Section III.D, the firm may also decide how much to invest in an internal-control mechanism, such as a compliance department, to supervise the manager and report wrongdoing to the government.

90. *See id.* at 245-46.

91. As discussed *infra* Section III.D, when the firm endogenously chooses to cooperate, the government will also select a discounted corporate fine of S_R for when the firm self-reports employee wrongdoing to prosecutors.

3. Finally, the manager chooses how to conduct business. His choice of productive and socially harmful effort is the pair of continuous variables $\langle m, n \rangle$, respectively. The manager can choose to exert any amount or combination of productive and socially harmful effort.

The players are rational in the traditional microeconomic sense: the government maximizes social welfare, the firm maximizes expected profit, and the manager maximizes expected utility. Using backward induction, one can solve for a Bayes-Nash equilibrium for the strategy that achieves socially optimal deterrence of corporate crime. That is, given how the firm will respond to the government's law enforcement policy and how the manager will respond to the combined incentives from the government and his employer, prosecutors will choose a strategy that most efficiently deters corporate crime.

The firm produces a single output with technology $G(m, n) = m + n$ and a price normalized to unity, so revenue is $m + n$. The firm offers the manager a contract with a fixed wage ω and a share μ of revenue. The manager can choose to either exert normal productive effort m or engage in socially harmful and illegal conduct with an effort choice of n. The manager experiences a combined personal disutility of $C(m, n)$ from either exertion.[92] The manager also receives a private benefit $E(n)$ from the socially harmful action that he does not share with the company, such as a bribe or a kickback.[93] Thus, the manager's utility function is

$$U = \omega + \mu(m + n) + E(n) - C(m, n) - \tau(n; \sigma, S_m, \pi), \qquad (1)$$

where $\tau(n; \sigma, S_m, \pi)$ is the manager's expected punishment as a function of his effort choice and the law enforcement policy.

Socially damaging behavior does not alone determine whether a crime has been committed. Following Garoupa, criminal liability attaches only under the condition $n + \varsigma > 0$, where u is a random variable with known cumulative distribution function $F(\varsigma)$. This random factor ς represents an exogenous determinant of whether the manager's illegal behavior produces the result element of the crime, such as the investor's loss in a securities fraud. For example, ς might be related to market conditions that cause a fraudulent investment scheme to collapse. The antisocial effort n corresponds to intentional actions by the individual that bring about a completed criminal act under the right conditions. For example, n could represent effort expended to create a fraudulent investment

92. The disutility to the manager of exerting both forms of effort is increasing and convex: $C_n > 0, C_m > 0, C_{nn} > 0, C_{mm} > 0$, and $C_{mn} = C_{nm} > 0$.

93. The private benefit to the manager of socially harmful effort is increasing in the harmful-effort level because $E_n > 0$, but there is a diminishing marginal return because $E_{nn} < 0$.

scheme that loses money and is discovered only when market conditions sour. The probability that a crime has occurred is $Pr(\text{crime}) = Pr(n + \varsigma > 0) = 1 - F(-n) = P(n)$.[94] If a crime does occur, it imposes a harm $H > 0$ on society. In sum, the occurrence of a crime with fixed social cost H depends on both the manager's antisocial effort choice n and exogenous conditions ς.

The firm's share of the output produced with the manager's effort is $(1 - \mu)G(m, n)$. If the manager's actions result in a crime that the prosecutor detects, the firm is fined an amount S_f. Thus, the firm's profit function is

$$B = (1 - \mu)(m + n) - \omega - P(n)\sigma S_f. \qquad (2)$$

Neither managerial utility nor profit depends on whether a crime occurs. However, if a crime occurs, the government can detect and successfully prosecute with probability σ. The government can impose three types of sanctions following a successful prosecution, depending on its announced crime-fighting strategy. If a corporate liability regime is in effect, the firm faces a fine of S_f. The manager faces a combination of two sentences: a fine S_m and a period π of incarceration. This incarceration generates expected disutility $J(\pi)$ to the manager and imposes social costs $D(\pi)$. The fines are transfer payments, so they do not affect social welfare.

The government sets law enforcement policy so as to maximize social welfare. Social welfare is the sum of managerial utility (U) and firm profits (B), net of the expected social harm of the crime and its punishment:

$$W = U + B - P(n)[H + D(\pi)]. \qquad (3)$$

The U.S. criminal justice system generally imposes long prison sentences, but as noted earlier, brief incarceration may produce sufficiently strong deterrence.[95] Many of the personal costs of incarceration appear immediately: family disruptions, stigma of criminal conviction, and psychological adjustment to lost freedom. Even though other costs grow over time, draconian sentences are usually unnecessary to serve a deterrence function. Mathematically, this appears as the disutility of incarceration function $J(\pi)$, which is highly concave with a very steep slope for low values of π.[96] As a consequence, managers subject to prosecution for corporate crimes will be risk seekers with respect to incarceration,

94. The probability of the social harm being realized is increasing in n: $P_n > 0$.

95. *See* Coffee, *supra* note 63, at 470.

96. The period of incarceration is at least zero, and the disutility of incarceration to the manager is concave, so $\pi \geq 0, J(0) = 0,\ J_\pi > 0,\ J_{\pi\pi} < 0$. The social costs of incarceration, such as prison operating costs and lost productivity, increase linearly with the period of incarceration: $D(0) = 0,\ D_\pi = d$.

even though they are risk-neutral overall.[97] While this Note generally refers to incarceration, this term is really a stand-in for nonmonetary sanctions imposed on individual wrongdoers. Thus, alternative sanctions that place the burden on individual managers, such as industry bans, restorative-justice initiatives, community service requirements, or some combination thereof, could suffice.[98] The point is not that incarceration per se is a necessary response to white-collar crime but that fines alone may not be a sufficient deterrent for many corporate crimes.

B. Observable-Effort Baseline

We begin with the simplest case: the manager's conduct is fully transparent and the corporation can contract for a specific level and type of managerial effort.[99] The observable-effort case serves as a baseline model of deterrence because the problem of corporate crime reduces to a single agency relationship between the government and the firm. The divergence between the firm's profit function and the government's social-welfare function creates the space for agency costs. This model closely follows the principal-agent framework developed in Garoupa[100] but adds the possibility of sentencing the manager to prison. It concludes that, when a defendant firm is TBTJ and has engaged in criminal conduct that is highly profitable and seriously harmful, corporate fines alone may not adequately deter criminal activity. Instead, optimal deterrence requires that prosecutors impose individual liability on managers, including a credible threat of incarceration.

Socially optimal deterrence requires that the firm and the manager together fully internalize the costs of their crime. That is, criminal penalties act as a Pigouvian tax, weighted by the probability of detection and punishment. A criminal control policy that forces the firm and the manager to fully internalize the costs of crime must therefore satisfy the joint condition[101]

$$S_f + S_m + J(\pi) = \frac{H+D(\pi)}{\sigma}. \qquad (4)$$

97. *See* Coffee, *supra* note 63, at 431 (arguing that the traditional microeconomic assumption that individuals are risk-averse should not apply to organizational criminal defendants operating under uncertainty).

98. *See generally* Dan M. Kahan, *What Do Alternative Sanctions Mean?*, 63 U. CHI. L. REV. 591 (1996) (exploring arguments for and against alternative sanctions to imprisonment such as community service).

99. The details of the derivation, which closely follow Garoupa's model, *see* Garoupa, *supra* note 64, appear in Appendix A.1.

100. *See* Garoupa, *supra* note 64, at 245-46.

101. *See infra* text accompanying equations (16)-(21) in Appendix A.1.

While (4) jointly defines an enforcement strategy that fully internalizes the costs of corporate crime, prosecutors face two important constraints in their charging and sentencing decisions.

First, in cases of serious corporate wrongdoing, even highly paid executives are unlikely to have sufficient recoverable wealth for a fine to fully internalize the social harms of large corporate crimes. Following Garoupa, let $\overline{W}$ represent the maximum collectable fine that can be imposed on the manager.[102] This imposes an individual-wealth constraint $S_m \leq \overline{W}$ on the government's choice of the manager's fine. If the crime's social harm weighted by the probability of discovery is high enough ($\overline{W} < H / \sigma$), then the individual-wealth constraint binds the prosecutor, and individual fines alone fail to fully internalize the costs of crime. If this constraint binds, then the remaining deterrence must be achieved through corporate fines and the threat of incarceration: $S_f + J(\pi) = \frac{H+D(\pi)}{\sigma} - \overline{W}$. Becker and other law-and-economics scholars argue incarceration is a second-best punishment because it imposes substantial social costs, so prosecutors should exhaust the utility of fines before turning to custodial sentences.[103] Absent the threat of prison, the optimal corporate fine reduces to $S_f = \frac{H}{\sigma} - \overline{W}$.

Second, the political economy of the TBTJ problem limits the total fiscal pain that the government can impose on systemically important firms. The model represents this practical upper bound on corporate liability as the collectable-wealth constraint $S_f \leq \xi$, which will be called the TBTJ constraint. If the government has adopted a criminal justice policy in which management is not credibly threatened with incarceration, then the sum of penalties has an upper bound of $\overline{W} + \xi$. In this policy regime, if the following condition holds, then rational managers will be underdeterred and financial crime will exceed socially optimal levels:

$$\overline{W} + \xi < \frac{H}{\sigma}. \tag{5}$$

Because deterrence regimes operate in expectation—that is, what matters for a manager's decision to commit antisocial behavior today depends on his understanding of the government's prosecutorial strategy—underdeterrence can hold whether $\pi = 0$ is a de jure or de facto policy. Thus, when both the individual-wealth and TBTJ constraints bind, a crime is harmful enough for (5) to hold,

102. *See* Garoupa, *supra* note 64, at 245-46.

103. *See* Becker, *supra* note 58, at 193; Posner, *supra* note 61, at 410 ("[T]he white-collar criminal . . . should be punished only by monetary penalties—by fines (where civil damages or penalties are inadequate or inappropriate) rather than by imprisonment or other 'afflictive' punishments."); *see also* Kahan, *supra* note 98, at 619-20 (presenting economists' arguments in favor of fines).

and there is no threat of incarceration, then the firm and its employees know ex ante that the government cannot force them to absorb the full costs of their antisocial behavior. The firm's decisions will therefore generate negative externalities—a socially suboptimal situation.

If incarceration is a sentencing option, then (4) dictates that the socially optimal expected period of incarceration should account for the deterrent effect of realistic fines. The length of incarceration that would fully internalize the costs of crime is given by[104]

$$\pi = J^{-1}\left[\frac{H+D(\pi)}{\sigma} - \bar{W} - \xi\right]. \tag{6}$$

Thus, where the TBTJ constraint binds sentencing decisions, socially optimal deterrence is only possible when $\pi > 0$ because the right side of the equation is necessarily positive for any harmful crime. As discussed in Section II.B, it is likely that even a short period of incarceration will satisfy (6) in most cases, since so much of incarceration's disutility is frontloaded. Recall that Michael Polinsky and Steven Shavell argued that imposing individual criminal liability can raise deterrence beyond a corporate-liability-only policy when the government's sanction on the manager is harsher than the firm's maximum possible sanction.[105] Since only the government can incarcerate an individual defendant, their criterion clearly holds here.

This perfect-information scenario simplifies the agency problems in play, establishing a baseline and clearly showing how the TBTJ problem changes behavior. Adding a TBTJ constraint to this model of organizational crime shows that criminal authorities with finite enforcement resources cannot cause TBTJ firms to fully internalize the costs of corporate crime without credibly threatening to incarcerate managers who commit crimes.[106]

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104. $J^{-1}(\cdot)$ exists because $J_\pi > 0$ by assumption.

105. *See* Polinsky & Shavell, *supra* note 64, at 251.

106. In Becker's standard framework, increasing the probability of punishment reliably decreases the crime rate. Since enforcement is costly and authorities have fixed budgets set by outside authorities, it is not always possible to increase the probability of conviction. But Becker's certainty/severity trade-off dictates that it is always possible to disincentivize criminality by increasing the applicable sentences. Here, assume that the prosecutor's level of enforcement σ is maximal given a fixed—but unspecified—enforcement budget, so he cannot willingly increase the probability of conviction. In this context and in the presence of a TBTJ firm, the only remaining margin for tightening criminal justice policy is individual liability.

C. Moral Hazard

In no large company do corporate shareholders and directors have perfect knowledge of managers' actions. And if a manager conducts business in a manner that may invite criminal charges, then shareholders and directors are even less likely to have visibility into his actions. Thus, a more fulsome analysis of corporate criminality requires modeling intrafirm information asymmetries. These asymmetries create moral hazard, which has long been identified as a primary cause of corporate criminality.[107]

Introducing moral hazard does not substantially change the policy implications with respect to the TBTJ constraint from those ascertainable in the perfect-information case presented in Section III.A. Moreover, Garoupa's original paper comprehensively analyzes the extension from the full-information context to the moral-hazard context.[108] Thus, a complete derivation of the model with information asymmetries is limited to Appendix A.2.

The main implication of this jump from full information to the intrafirm information asymmetry is that the moral hazard adds a second-level, nested agency relationship between the firm and its manager to the relationships emanating from the prosecutor. This added agency relationship requires the firm to create an incentive structure such that the manager will rationally choose to maximize productive effort and minimize illegal conduct. As Garoupa explained, this information asymmetry introduces intrafirm-incentive distortions that reduce productive efficiency relative to the perfect-information baseline.[109] I represent the cost of those incentive distortions as $\zeta(\mu)$. However, the implications of the TBTJ problem are unchanged relative to the perfect-information baseline: absent a credible threat of nonmonetary sanctions for culpable managers, prosecutors will be unable to sufficiently deter crime by employees of TBTJ corporations.

D. Moral Hazard with Internal Controls

Most large firms invest in legal compliance departments to monitor employees.[110] Internal-control mechanisms improve intrafirm incentives, reducing productive inefficiency. However, investing in costly internal controls depends on

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107. *See* Alexander, *supra* note 7; *see also supra* Part II.

108. Garoupa, *supra* note 64, at 246-48.

109. *Id.* at 246-47.

110. *See* Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 951-52 (2009); Diana E. Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 87 IOWA L. REV. 697, 707-14 (2002).

corporate exposure to criminal sanction. The model demonstrates that the TBTJ problem disfavors corporate investment in employee supervision and cooperation with criminal investigations.

The firm can monitor the manager's activities through a compliance department more efficiently than outside law enforcement can because employers have insider knowledge of their workers' responsibilities, conduct, and communications. If the firm detects wrongdoing by a manager, it is expected to report the crime to the government. For the firm to detect employee wrongdoing with probability ρ, it will have to spend an amount $T(\rho)$ on supervision.[111]

The government has two ways of inducing companies to invest in internal controls and report wrongdoing to regulators. First, it can directly mandate internal controls through corporate law, securities laws, or sectoral regulations.[112] Second, the government can create economic incentives for firms to invest in internal controls as a means of reducing vicarious liability for employee malfeasance. If these internal controls are costly to implement, and if the crime imposes few direct costs on the firm, then corporate liability is necessary to induce the firm to invest in a compliance department. Internal controls can reduce the incidence of employee malfeasance through deterrence and discipline. But the government also incentivizes this investment by providing corporate defendants with discounts on fines for operating a properly functioning compliance system and for self-reporting employee wrongdoing. Since these economic incentives are the model's focus, for now we will ignore general regulatory and corporate law requirements that firms have compliance programs.

To permit the government to strengthen firms' incentives to invest in internal controls, a new term in the set of policy parameters, S_R, will represent the fine imposed on the corporation when it self-reports the manager's wrongdoing to the government. S_f remains the fine imposed on the firm when government detects the wrongdoing.[113] The manager is subject to the same sentence regardless of how he is caught.

Now subject to the firm's monitoring, the manager's utility is

$$\begin{aligned} U = \omega + \mu(m+n) + E(n) - C(n,m) \\ - P(n)[\rho + (1-\rho)\sigma][S_m + J(\pi)]. \end{aligned} \tag{7}$$

111. $T_\rho > 0$.

112. *See* Baer, *supra* note 110; *see, e.g.*, 17 C.F.R. § 270.38a-1 (2018) (imposing a compliance regime on investment companies).

113. While it makes sense for firms to get a "discount" on their liabilities when they cooperate with the government by turning over evidence of employee wrongdoing, Garoupa shows that $S_R < S_f$ is insufficient to incentivize the firm to fund internal controls. *See* Garoupa, *supra* note 64, at 250.

Because effort is unobservable, the manager optimizes his effort choice subject to the criminal-policy and compliance parameters. Given the manager's response to intrafirm incentives, the firm maximizes profit by choosing both the revenue-sharing factor μ and how much to invest in strengthening its compliance department ρ.[114]

The manager chooses to maximize his productive effort $\widetilde{m}$ when he receives the entire revenue ($\mu = 1$). But so long as the firm faces some corporate liability, it will require some retained earnings to compensate for its legal risk, and so the firm will be unwilling to pay the manager the full value of his effort.[115] Absent corporate liability, however, the firm has no incentive to invest in costly compliance measures. Algebraically, if there are no corporate fines, $\langle S_R = 0, S_f = 0\rangle$, then the firm will not detect and report any managerial wrongdoing ($\rho = 0$). However, an internal-control mechanism improves intrafirm incentives because increasing compliance-department strength ρ decreases the manager's choice of antisocial effort for any given revenue share μ.[116] Thus, by employing an internal-control mechanism, the firm can achieve any specified level of deterrence while sacrificing less productive efficiency than it can without a compliance department.

As before, the government sets optimal criminal policy by maximizing social welfare.[117] Building on Garoupa by imposing both binding individual-wealth and TBTJ constraints, the optimal period of incarceration is given by

$$\pi = J^{-1}\left[\frac{H+D(\pi)}{\rho+(1-\rho)\sigma} - \overline{W} - \xi - \zeta(\mu)\right]. \tag{8}$$

Since $\rho + (1-\rho)\sigma$ is increasing in ρ, equation (8) shows that as the firm increases the strength of its compliance function, prosecutors can impose shorter prison sentences and maintain deterrence strength. In other words, employees of firms with strong compliance departments should expect to be caught committing crimes more often but need not face punishment as severe as those working in companies without such internal controls.

Relying solely on corporate liability makes the underdeterrence problem worse. If firms and managers expect that the government will not impose individual liability on managers, then the TBTJ constraint will bind when

$$H \geq [\rho + (1-\rho)\sigma](\xi) - \zeta(\mu). \tag{9}$$

114. This derivation of the firm's contract set $\langle\tilde{\mu}, \tilde{\rho}\rangle$, conditional on the announced law enforcement policy, is worked out in the mathematical appendix. *See infra* Appendix A.3.

115. This conclusion follows from equations (41) and (33). *See infra* Appendix A.3.

116. *See id.* at equation (34); *see also* Garoupa, *supra* note 64, at 249.

117. For details of this derivation, see *infra* Appendix B.

Comparing equations (9) and (46), it is clear that the TBTJ constraint will bind the prosecutor's charging decision at lower levels of social harm H without individual liability than when managers are subject to fines, so crime control will be further from its social optimum.

Even if the manager faces a fine, when the TBTJ constraint binds, fully internalizing the social costs of crime is impossible without incarceration, as it is the only remaining margin in sentencing for making the firm and its manager internalize the costs of crime. Because the firm must offer the manager an employment contract that satisfies his incentive-compatibility constraint to elicit its desired effort level $\langle \tilde{n}, \tilde{m} \rangle$, the firm pays the "price" of crime not only through corporate fines but also through employee wages and revenue shares μ. If the criminal justice policy protects managers from the threat of incarceration, the maximum expected sanction a TBTJ firm will face when it elicits a given level of effort $\tilde{n}$ is

$$\Xi(\tilde{n}) = P(\tilde{n})[\rho + (1-\rho)\sigma](\xi + \bar{W}). \qquad (10)$$

But the highest credible threat is likely to be even less because, as the next Part explains, TBTJ firms will not invest in a compliance function that reports wrongdoing to the government. Mathematically, this means that if a firm is TBTJ, $\rho = 0$ will hold in equation (10). If the government is not expected to incarcerate the manager, then the TBTJ firm will expect to profit from increasing its managers' exertion of socially harmful effort $\tilde{n}$ when

$$E_n(\tilde{n}) > C_n(\tilde{n}; \tilde{m}) + \Xi_n(\tilde{n}) - 1. \qquad (11)$$ [118]

That is, encouraging antisocial activity will be profitable for the TBTJ firm so long as the manager's marginal private benefit from further cheating is greater than the marginal disutility of that effort and increased costs to the firm of being caught, because additional unlawful conduct raises the likelihood that a crime will be committed and the firm prosecuted.

In other words, when managers feel immune from the threat of jail, TBTJ firms may find it profitable to induce their employees to commit crimes even when they expect the government may occasionally detect wrongdoing. By contrast, when prosecutorial strategy creates a credible threat of incarceration for the manager, then deterrence could be optimized beyond this TBTJ limit. However, if prosecutors rely solely on corporate fines, and culpable managers do not fear punishment, then crime can pay for TBTJ firms.

118. This follows from equations (39) and (10). *Infra* Appendix A.3.

IV. THE TOO-BIG-TO-JAIL FIRM'S DISINCENTIVE TO COOPERATE

Current DOJ strategy relies on firms to cooperate with government investigations. But does this approach make economic sense when defendant firms are TBTJ? This Part argues that TBTJ firms lack incentives to cooperate in good faith with the government under certain conditions, and so existing strategies may fail to account for the concentration of TBTJ firms in today's economy. The government seeks to induce good-faith cooperation by giving a carrot-and-stick structure to corporate criminal liability. As explained in Section III.D, under this law enforcement policy, a firm can disclose misconduct by its agents to prosecutors in return for a discounted fine, S_R, which is less than what it would have paid had the government detected the wrongdoing itself, S_f. By adopting such a strategy, the government incentivizes the firm to invest in internal compliance, which can monitor managers' activities and report misconduct.

This strategy reflects current DOJ policy, which provides both formal leniency programs for corporations that self-report wrongdoing and more general guidance on how corporate cooperation ought to affect charging decisions. Since 1993, DOJ's Antitrust Division has provided a criminal amnesty program for the first corporation to self-report cartel activity; self-reporting under this regime permits the first corporation in the door to avoid all criminal penalties for itself and its managers.[119] DOJ's Fraud Section launched a one-year pilot of a formal leniency program for firms that self-report bribery and corruption activities, offering "up to a 50% reduction off the bottom end of the Sentencing Guidelines fine range, if a fine is sought."[120] The pilot was "intended to encourage companies to disclose FCPA misconduct to permit the prosecution of individuals whose criminal wrongdoing might otherwise never be uncovered by or disclosed to law enforcement."[121] This program was specifically aimed at increasing the effectiveness of the Yates Memo's incentives for corporate cooperation against culpable

119. *See* Antitrust Div., *Corporate Leniency Policy*, U.S. DEP'T JUST. (Aug. 10, 1993), https://www.justice.gov/atr/file/810281/download [https://perma.cc/PY4A-NY25]. *See generally* Antitrust Div., *Leniency Program*, U.S. DEP'T JUST. (Feb. 20, 2018), https://www.justice.gov/atr/leniency-program [https://perma.cc/8FZP-Q3JM] (describing the terms and conditions of DOJ's amnesty program).

120. Criminal Div., *The Fraud Section's Foreign Corrupt Practices Act Enforcement Plan and Guidance*, U.S. DEP'T JUST. 8 (Apr. 5, 2016), https://www.justice.gov/opa/file/838386/download [https://perma.cc/K6VE-4J2L] [hereinafter *FCPA Enforcement Plan*]. The pilot program was replaced by a new FCPA corporate-enforcement strategy in November 2017. *See* Criminal Div., *Evaluation of Corporate Compliance Programs*, U.S. DEP'T JUST. (Feb. 8, 2017), https://www.justice.gov/criminal-fraud/page/file/937501/download [https://perma.cc/HP4X-95UY].

121. *FCPA Enforcement Plan*, *supra* note 120, at 9.

individuals, which aimed at increasing deterrence.[122] Indeed, these leniency programs operate against the backdrop of the Justice Manual's Principles of Federal Prosecution of Business Organizations, which have long counseled prosecutors to extend leniency to firms that cooperate in investigations of their agents, voluntarily disclose wrongdoing, and implement credible compliance programs.[123]

Intuition derived from Becker's economic analysis of crime might suggest that increasing corporate fines should always reduce the level of corporate crime and increase firms' efforts to supervise managers. However, when a firm funds an internal-control mechanism that reports crimes to the government, there can be a "potentially perverse effect" where the expected cost of more frequent detection and conviction outweighs the expected benefit of self-reporting discounts from the authorities and improved managerial incentives.[124]

The model describes both investment in a corporate compliance program and in an internal investigation pursuant to government prosecution. In either case, the firm faces the decision whether to investigate and disclose any wrongdoing by its agents. Doing so increases the likelihood of prosecution overall, because the firm will inform the government about some criminal conduct that the government would not have discovered on its own, but the internal controls may provide for reduced penalties if conduct is self-reported rather than detected by prosecutors.[125]

The firm's incentive to invest in compliance programs is measured by the marginal benefit from compliance-department funding

$$\Psi = \sigma S_f - S_R - (1-\sigma)\big(S_m + J(\pi)\big) - \frac{T_\rho}{P(\tilde{n})}. \qquad (12)^{126}$$

If the marginal sanctions benefit from compliance-department funding is positive, then it is economically rational for the firm to increase spending on internal controls. But if $\Psi < 0$, then the firm has a perverse incentive: additional "investment" in compliance produces a negative return, since the costs of more frequent

122. *Id.* at 2.

123. JUSTICE MANUAL, *supra* note 8, § 9.28.300.

124. *See generally* Arlen, *supra* note 88.

125. The firm determines its compliance spending from equation (38), the firm's first-order condition with respect to ρ. *See infra* Appendix A.3. The first two terms are positive because intrafirm supervision improves the manager's incentives, increasing productive effort and decreasing socially harmful effort, since $\tilde{n}_\rho < 0$ by equation (34). The last term, T_ρ, represents the marginal cost to the firm of funding additional internal controls. *See* Garoupa, *supra* note 64, at 249.

126. This relation represents the return from investment in internal control, as described by the first-order condition in equation (38). Equation (12) incorporates the term in the square brackets in equation (38), which represents the marginal savings in expected criminal penalties and the marginal cost of internal control weighted by the probability of a crime occurring.

detection outweigh the benefits of corporate responsibility. When $\Psi = 0$ holds, both increasing penalties $\langle S_R, S_m, \pi \rangle$ and decreasing government investigative strength, as measured through the detection probability σ, will cause the corporation to reduce spending on internal controls. This result is qualitatively different from the standard certainty/severity trade-off entailed in Becker's framework, where the idea that probability of detection and severity of punishment are strategic substitutes extended to the problem of deterring the "corporate mind" from pursuing crime. That is, counterintuitively, at a certain point, increasing corporate penalties may motivate the firm to act lawlessly rather than deter it from criminality as Becker's standard trade-off suggests.

There are two limit cases for corporate liability. First, consider when law enforcement policy does not include any corporate liability ($S_R = S_f = 0$). Inserting this condition into equation (12) shows that Ψ will be negative, regardless of how prosecutors set their other policy parameters (investigative strength and criminal penalties for individuals).[127] That is, in the absence of corporate liability, the firm's incentive is always perverse, so the firm never invests in compliance, even if internal controls are more efficient than intrusive government investigations. Following the derivation in Appendix A.3, a corporate liability structure is optimal if

$$\rho S_R + (1-\rho)\sigma S_f = H - [\rho + (1-\rho)\sigma]\overline{W}. \qquad (13)^{128}$$

However, if there is no corporate liability and no threat of individuals facing jail time ($S_R = S_f = \pi = 0$), and so long as the crime is socially harmful ($H > 0$), equation (13) can never hold. Consequently, if policy makers want corporations to report employee malfeasance or to invest in costly structural reforms, corporate liability is required.

The second limit is reached when corporate liability is maximal, so the TBTJ constraint fully binds: $\langle S_R = \xi, S_f = \xi \rangle$. This occurs when a firm's criminal activity is so profitable and so socially harmful that appropriate penalties run up against the TBTJ constraint—whether or not the firm cooperates. In other words, this condition holds when the appropriate fine would imperil a TBTJ firm, even after the discount for cooperation credit. The BNP Paribas sanctions case is an example of this situation[129]: at the government's behest, the bank spent millions of dollars on internal investigations over several years. Nevertheless, even with credit for cooperation, the fine was still so large that financial-stability pressures prevailed in reducing its punishment. At this upper limit of corporate liability

127. That is, $\Psi \leq 0 \;\forall\; \langle \sigma, S_m, \pi \rangle$.

128. This follows from equation (45) but for clarity ignores the social cost of intrafirm incentive distortion.

129. *See supra* notes 29-34 and accompanying text.

$$\Psi^{\text{TBTJ max}} = -(1-\sigma)\big(\xi + S_m + J(\pi)\big) - \frac{T_\rho}{P(\tilde{n})}. \qquad (14)$$

Equation (14) shows that when the TBTJ constraint fully binds, Ψ will be negative for all possible values of the other enforcement parameters. Thus, a TBTJ firm will never have an incentive to invest in compliance or to self-report very profitable (and very harmful) employee crimes.

But the firm's incentive to invest in compliance begins to diminish under even weaker conditions. When the TBTJ constraint partially binds, which happens when the fine incurred for government-detected criminality is maximal but the fine for firm-reported wrongdoing is not, $\langle S_f = \xi, S_R < \xi \rangle$, the marginal return from internal-control investment is

$$\Psi^{\text{TBTJ partial}} = \sigma\xi - S_R - (1-\sigma)\big(S_m + J(\pi)\big) - \frac{T_\rho}{P(\tilde{n})}. \qquad (15)$$

While the firm's returns from investing in the compliance department may still be positive for some portions of the remaining policy space, the incentive strength is decreasing in all remaining sanction parameters.[130] That is, once the noncooperative fine has reached its upper limit, tightening any of the other penalties will induce the firm to cut back on internal controls. At the level of the firm as a whole, this represents another departure from Becker's familiar prediction, because increasing the severity of punishment will not change the overall deterrence of corporate crime.

Thus, the government will struggle to incentivize TBTJ companies to invest in meaningful and transparent internal-control mechanisms. If the government wants TBTJ companies to invest in corporate-crime prevention, it should *mandate* investment by including structural-reform requirements and independent monitorships in settlement agreements. Like sectoral regulations, these mandates eschew reliance on general deterrence to create economic incentives for good corporate behavior and instead require that the company create adequate internal controls.

Outside the context of an ongoing investigation, there are reasons to prefer a regime requiring corporate compliance to one wholly reliant on government investigation to discover criminal conduct. First, credible corporate compliance mechanisms conserve public resources. The intrusive investigations necessary to ferret out wrongdoing absent corporate cooperation would be very resource intensive. And in the context of TBTJ firms, where fines cannot be raised above the TBTJ limit, the only way to achieve adequate deterrence would be to ratchet up the government's investigative strength substantially. Thus, it is a more effective use of prosecutorial resources to exert pressure on firms sufficient to in-

130. $\Psi_i < 0 \; \forall \, i \in \{S_R, S_m, \pi\}$.

duce their investment in internal controls. Second, internal compliance programs are likely more effective and efficient at discovering wrongdoing than government investigations. Companies' internal investigators have broad access to corporate and employee information and can draw on privileged and confidential information about firm strategy and practices to understand managers' activities. Finally, absent credible internal controls within companies, the government would have to engage in more intrusive and disruptive surveillance. Credible internal controls can help prevent and root out malfeasance without requiring the government to use dragnet tactics.

Of course, these benefits only accrue if the internal controls function as meaningful checks on corporate action, with the institutional position, independence, and resources necessary to constrain a business's profit centers. Where a firm treats internal controls as box-ticking exercises and its compliance system as a business-prevention department to be circumvented, the government should not rely on self-reporting to uncover wrongdoing. However, if managers anticipate that future criminal investigations will involve truly searching and independent government investigation that could result in individual penalties, then they might be more willing to establish credible internal controls.

Also, note that the firm's decision-making parameter in this model is the level of cooperative internal control, ρ, not the capital invested in that effort. Companies can, if they choose, spend money creating ineffective or uncooperative internal control programs. These programs could be either mere window dressing that fails to detect any wrongdoing or programs that cooperate in bad faith by withholding incriminating information unless confronted by the government with evidence of particular illegal conduct. Either way, spending on internal controls may fail to actually increase ρ. This presents a challenge to prosecutors, who can usually evaluate corporate cooperation only by proxy measures and through relationships of credibility and trust. However, this analysis suggests that where firms are TBTJ, exposure for bad-faith "cooperation" may not credibly increase corporate criminal penalties. Prosecutors should thus avoid relying on economic incentives and reputational concerns to elicit genuine cooperation.

These findings have implications for corporate-crime-control policy in the era of TBTJ firms. Consider the case of financial crime within the banking sector. Once banks have reached the size and level of interconnectedness where they are TBTF and the banking sector's criminality produces large-scale social damage, increasing the severity of corporate and individual sanctions will not strengthen incentives for financial institutions to increase internal controls that reveal wrongdoing to public authorities. If the TBTJ constraint binds sanctions for unreported criminal activity as in equation (15), the advice that emerges from a direct application of Becker's standard certainty/severity trade-off—increase penalties for firm-reported malfeasance and decrease costly public law enforcement—does not hold for firm-level decision-making. Equation (14) suggests that policy where prosecutors impose maximal fines on cooperative corporations that report employee wrongdoing should not be expected to induce them to spend more to detect and turn over violators in their ranks.

Put simply, when firms know that a prosecutor's decision as to how much fiscal pain they can be made to suffer is constrained by their status as TBTJ institutions—whether or not they self-report their employees' crimes—they expect to gain nothing by cooperation. Rational prosecutors should not, therefore, expect rational TBTJ companies to cooperate in good faith when it comes to investigating and reporting serious wrongdoing by employees.

V. STRATEGIC IMPLICATIONS FOR CORPORATE CRIMINAL PROSECUTION

More than ever, law enforcement strategy relies on companies' cooperation to deter corporate crime. The 2015 Yates Memo, DOJ's latest amendment to the Principles of Federal Prosecution of Business Organizations, relies on good-faith corporate cooperation, both before and after a government investigation commences. This Note explains why, even if self-regulation is generally effective, reliance on corporate self-interest is misplaced when dealing with TBTJ firms. If the government is constrained in the possible sanctions it might employ, authentic cooperation is economically irrational. Prosecutors therefore cannot assume that apparent cooperation is authentic.

This conclusion has two key implications. First, prosecutors should use substantive mandates and independent monitors to ensure that corporate compliance is more than window dressing. DOJ's charging guidelines consider adequacy of internal controls, so defendant companies have a strong incentive to trumpet investments in compliance programs.[131] However, Garrett found that "[p]rosecutors appoint monitors quite unevenly," while "[i]n contrast, judges in large corporate convictions commonly appoint monitors or special masters."[132] An effective independent monitor can verify that a compliance program actually stops and reports criminal activity by corporate employees, even at the cost of

131. JUSTICE MANUAL, *supra* note 8, § 9-28.300(A)(7) (explaining that prosecutors should consider "the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one" in deciding whether to bring charges).

132. GARRETT, *supra* note 1, at 177-78.

profits.[133] Absent a monitor, prosecutors rely on the deterrent threat of further prosecution to induce a company to take structural and cultural reform seriously. But since a TBTJ firm may lack incentives to self-report crimes, prosecutors negotiating settlements should consider TBTJ status as an indication that an independent monitor is warranted.

Some commentators describe independent-monitor systems as incurious and captured, but this may be a consequence of bad institutional design creating poor incentives.[134] Some scholars have argued that "prosecutors should not impose structural reforms on nonindicted corporations," because their inexperience in running businesses may impose excessive costs.[135] Today, line prosecutors maintain primary responsibility for supervising an internal monitor during a DPA's pendency, and DOJ's recent policy statement on the use of monitors intends to further decentralize supervision of monitors.[136] But prosecutors rightly focus on building and trying cases, not supervising the details of corporate reform. Thus, this Note's legislative proposal would improve the monitoring system by centralizing DOJ's supervision of monitors and increasing transparency.[137]

The second strategic implication involves prosecutors' mode of criminal investigation. Prosecutors often rely heavily on a corporate defendant's internal investigation, usually conducted by outside counsel and sometimes with the assistance of various professional-services firms.[138] These engagements are now

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133. *See, e.g.*, *id.* at 183-86 (describing the corporate monitor's success and key role in institutionalizing compliance reforms at Siemens A.G. following its settlement of FCPA violations).

134. *See* Veronica Root, *Constraining Monitors*, 85 FORDHAM L. REV. 2227, 2243 (2017); *id.* at 2229 (arguing that the chief incentive governing monitorships is often the monitor's self-interest in maintaining a good reputation, despite potential conflicts with disclosure, cronyist appointment processes, and limited systems for sanctioning misconduct).

135. Jennifer Arlen, *Removing Prosecutors from the Boardroom: Limiting Prosecutorial Discretion to Impose Structural Reforms*, *in* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 62, 63 (Anthony S. Barkow & Rachel E. Barkow eds., 2011).

136. *See Assistant Attorney General Brian A. Benczkowski Delivers Remarks at NYU School of Law Program on Corporate Compliance and Enforcement Conference on Achieving Effective Compliance*, U.S. DEP'T JUST. (Oct. 12, 2018), https://www.justice.gov/opa/speech/assistant-attorney-general-brian-benczkowski-delivers-remarks-nyu-school-law-program [https://perma.cc/D8GJ-DCZV].

137. *See infra* Section VI.B.3.

138. *See* Michael A. Simons, *Vicarious Snitching: Crime, Cooperation, and "Good Corporate Citizenship*,*"* 76 ST. JOHN'S L. REV. 979, 995-97 (2002). Outside counsel lead internal investigations, but professional-services firms, including the Big Four accountancy firms, often perform transaction analysis, document recovery, and forensic accounting.

big business in themselves, and they come with attendant revolving-door concerns.[139] The suspect company is usually responsible for the costs and hiring decisions, though choice of investigators is subject to prosecutorial approval. In many cases, prosecutors end up entirely reliant on internal investigations for activities such as the collection and production of relevant documents, identification of "hot" documents for further review, analysis of financial and technical data, and employee interviews. Lawyers and their private investigators continually face difficult ethical questions about their dual roles as counsel to the defendant and agent of the prosecutor because all inculpatory information disclosed may increase their clients' liabilities.[140]

This system creates numerous conflicts of interest, both for the client and the investigators. Clients have obvious incentives to appear cooperative while actually secreting away evidence of as-yet-undiscovered wrongdoing or otherwise obstructing internal investigations. In a sprawling, multinational corporation, management may target an internal investigation narrowly to turn over only information about malfeasance of which the government is already aware but conceal information about other, related wrongdoing. Absent a whistleblower or a mistake, this strategy may never be revealed to the government. For a small company under investigation, any significant resistance may trigger a more aggressive government response, such as indictment.[141] But for a TBTJ corporation, there may be little additional downside to obstruction, since prosecutors may not be able to increase punishments in any meaningful way.

The case of the British bank Standard Chartered shows how subsequent discovery of incomplete disclosure may not significantly increase punitive sanctions. After reaching a DPA in 2012 over sanctions-evasion charges, prosecutors reopened the case in 2014 to examine whether the bank's internal investigation had failed to disclose the extent of its wrongdoing.[142] The bank ultimately agreed

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139. *See generally* Andrew Longstreth, *Double Agent*, AM. LAW. (Feb. 1, 2005, 12:00 AM), https://www.law.com/americanlawyer/almID/1106573737942 [https://perma.cc/64FZ-JXCR].

140. *See* Sarah Helene Duggin, *Internal Corporate Investigations: Legal Ethics, Professionalism and the Employee Interview*, COLUM. BUS. L. REV. 859, 865 (2003) ("Even sophisticated employees often fail to appreciate that corporate counsel may metamorphose into de facto government agents.").

141. *See, e.g.*, Gretchen Morgenson, *A Tiny Bank's Surreal Trip Through a Fraud Prosecution*, N.Y. TIMES (July 17, 2015), http://www.nytimes.com/2015/07/19/business/a-tiny-banks-surreal-trip-through-a-fraud-prosecution.html [https://perma.cc/VE9U-VB3X] (describing the prosecution of Abacus Savings Bank).

142. Chad Bray, *Standard Chartered Agrees to 3-Year Extension of Nonprosecution Agreements*, N.Y. TIMES: DEALBOOK (Dec. 10, 2014, 4:53 AM), http://dealbook.nytimes.com/2014/12/10/standard-chartered-extends-deferred-prosecution-agreements-for-3-years [https://perma.cc/8SU7-R3L9].

to a three-year extension of the settlement but paid no more.[143] This treatment seems not to have deterred Standard Chartered from further illegality: in 2016, DOJ reportedly opened a Foreign Corrupt Practices Act (FCPA) investigation into bribery alleged to have happened in 2014 and 2015.[144]

The firms that defendants hire to conduct internal investigations must also manage the conflicts of interest intrinsic to investigating and reporting on the client that pays the bills. Internal investigations are a lucrative business. The same set of professional-services firms repeatedly face off in pitches to potential internal-investigations clients, and defendant-friendly outcomes in past cases are crucial credentials. Yet during an investigation, attorneys, accountants, and consultants face decisions about how hard to push an investigative angle and what facts to disclose to the government. In the face of an uncooperative client or its stonewalling employees, an incurious investigator need not be dishonest to miss evidence of corporate guilt. Attorneys running internal investigations also have an ethical duty to abide by their clients' lawful directions for a representation's objective;[145] this permits a defendant company to curtail disclosure of inculpatory information. Thus, investigators continually face difficult decisions when commitments to professional ethics and concerns about their reputations with the government run headlong into their firms' financial incentives.

The incentives problem is magnified when a TBTJ defendant engages a TBTJ professional-services firm to investigate. In the event that obstruction is revealed, neither entity will likely be subject to the full strength of criminal sanction. Withholding inculpatory information is not a hypothetical concern: in 2014, the New York Department of Financial Services fined PricewaterhouseCoopers $25 million for "improperly altering" a report at the behest of its client, The Bank of Tokyo-Mitsubishi, which was under investigation for violations of U.S. economic sanctions.[146] PricewaterhouseCoopers is one of the Big Four accounting firms, which the federal government had previously signaled was TBTJ.[147]

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143. *Id.*

144. Ben Otto & Margot Patrick, *Standard Chartered Faces U.S. Probe over Indonesian Investment*, WALL ST. J. (Sept. 27, 2016, 5:30 AM ET), http://www.wsj.com/articles/standard-chartered-faces-u-s-probe-over-indonesian-investment-1474968604 [https://perma.cc/C7BB-R3RP].

145. *See* MODEL RULES OF PROF'L CONDUCT R. 1.2 (AM. BAR ASS'N 2018).

146. Ben Protess & Jessica Silver-Greenberg, *Bank of Tokyo Fined for 'Misleading' New York Regulator on Iran*, N.Y. TIMES (Nov. 18, 2014, 4:20 PM), http://dealbook.nytimes.com/2014/11/18/lawsky-fines-bank-of-tokyo-mitsubishi-ufj-another-315-million [https://perma.cc/4RG7-F2FK].

147. *See* ROSTAIN & REGAN, *supra* note 43.

Conflicts of interest remain whenever prosecutors permit a defendant firm to demonstrate cooperation through compliance reforms or investigative assistance, but risks of bad faith cooperation are heightened when the defendant is TBTJ. This Note's model suggests that in the TBTJ context, prosecutors must credibly threaten incarceration for culpable individuals to effectively deter corporate crime. DOJ has embraced this view in the 2015 Yates Memo, encouraging prosecutors to pursue individual convictions rather than just corporate settlements. But this strategy is troubled to the extent that it relies on TBTJ companies to disclose individual wrongdoing. Particularly where such evidence would increase an organization's exposure to additional criminal or civil liability, it may be irrational for the firm to cooperate in good faith.

VI. REFORMING CORPORATE SETTLEMENT

Corporate fines without individual accountability underdeter criminal conduct by and within TBTJ companies. But then why are so few corporate criminal settlements accompanied by indictments of culpable employees? This Part begins by advancing a structural explanation for why relatively few individual prosecutions emerge from large corporate criminal investigations: the federal courts' inability to substantively review DPAs creates a dynamic vulnerable to tacit collusion. Absent robust judicial scrutiny, prosecutors and TBTJ defendants may negotiate settlements that serve their own financial, professional, and political ends but insufficiently protect the public interest, because they create only weak incentives to remediate corporate wrongdoing. I then introduce the DPA Procedures Act,[148] a legislative proposal that would reintroduce robust judicial review and meaningful criminal procedures into the DPA settlement process. This legislation would address existing structural problems with DPA practice in two ways. First, it would provide defendants with an opportunity, short of a bet-the-company criminal trial, to convince a court that the government's theory of the case is either factually or legally deficient. And second, the Act would require prosecutors to seriously investigate individual wrongdoing before obtaining the political benefit of a headline-grabbing corporate settlement, thereby increasing the government's incentive and ability to prosecute culpable individuals.

148. *See infra* Appendix B.

A. *Identifying the Source of the Problem*

1. *The Law and Practice of Deferred Prosecution Agreements*

Prosecutions of large corporations only occasionally end in plea agreements and seldom go to trial. DPAs are the norm, even though they are subject to few statutory procedures or binding regulations. Instead, prosecutors negotiating DPAs operate under guidance memos issued by Deputy Attorneys General and supervision from senior DOJ officials. Over the years, this practice among repeat players has produced a set of conventions about the process and substance of DPAs.

DPAs find their statutory basis in 18 U.S.C. § 3161(h)(2), a provision of the Speedy Trial Act that excludes from the statutory clock "[a]ny period of delay during which prosecution is deferred by the attorney for the Government pursuant to written agreement with the defendant, with the approval of the court, for the purpose of allowing the defendant to demonstrate his good conduct."[149] A joint motion for exclusion under § 3161(h)(2) generally includes the prosecutor's criminal information charging the defendant company, the defendant's waiver of its right to indictment, a statement of facts outlining the basis for charges, and the operative agreement stating the DPA's terms and penalties.

When Congress enacted the DPA provision of the Speedy Trial Act in 1974, the floor debates discussed diversion of juvenile drug and prostitution offenders, not corporations. The practice of deferring prosecution had been invented in the 1930s in the Eastern District of New York to avoid incarcerating young adults for nonviolent drug and prostitution offenses.[150] By 1974, the "Brooklyn Plan" was widely used by prosecutors in New York City and Washington D.C.[151] After codifying the Sixth Amendment speedy-trial right, Congress had to provide this statutory exclusion for DPAs to remain feasible.[152]

DPAs require court approval under § 3161(h)(2), and the legislative history reveals this was deliberate. Earlier bill drafts lacked the "with the approval of the

149. 18 U.S.C. § 3161(h)(2) (2018).

150. Stephen J. Rackmill, *Printzlien's Legacy, the "Brooklyn Plan," A.K.A. Deferred Prosecution*, 60 FED. PROB. 8, 9 (1996).

151. ANTHONY PARTRIDGE, FED. JUD. CTR., LEGISLATIVE HISTORY OF TITLE I OF THE SPEEDY TRIAL ACT OF 1974, at 117 (1980).

152. S. REP. NO. 36-37 (1974), *as reprinted in* PARTRIDGE, *supra* note 151, at 117.

court" clause and would have given the prosecuting U.S. Attorney complete discretion to set the DPA's terms.[153] In a 1971 Senate hearing, a former prosecutor argued that because a DPA "has some elements of a plea bargain . . . approval by the court on the record is a wise and necessary safeguard."[154] Congress agreed, requiring judicial supervision despite DOJ's claim that court oversight would infringe on the separation of powers.[155]

In two recent opinions, the D.C. and Second Circuits have reversed trial courts' review of DPAs, declining to find either inherent or statutory authority for any level of meaningfully intensive review.[156] The Second Circuit's decision emerged from the HSBC money-laundering case. While the DPA was pending and charges remained on the docket in the Eastern District of New York, Judge Gleeson granted a private citizen's motion to unseal one of the reports filed with the court by the independent monitor.[157] Chief Judge Katzmann's opinion ultimately reversed the district court's unsealing order because it concluded that the report was not a judicial document.[158] But first it inquired whether Judge Gleeson had properly invoked the district court's supervisory authority in requiring the monitor's reports to be filed with the court.[159] The Second Circuit found that absent "clear evidence" of prosecutorial misconduct, the district court's supervisory power did not authorize substantive review of a DPA's terms, because prosecutors are entitled to both a presumption of regularity and the exercise of prosecutorial discretion.[160] Chief Judge Katzmann also declined to construe § 1361(h)(2) to authorize judicial review of a DPA's substantive terms, "[a]t least in the absence of any clear indication that Congress intended courts to evaluate the substantive merits of a DPA or to supervise a DPA's out-of-court implementation," because Congress legislated "against the backdrop of long-

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153. *See* Pretrial Crime Reduction Act of 1971, H.R. 7101, 92nd Cong. (as proposed in H. Comm. on the Judiciary, Apr. 1, 1971), *as reprinted in* PARTRIDGE, *supra* note 151, at 280-81.

154. PARTRIDGE, *supra* note 151, at 116.

155. *See Speedy Trial Act of 1974: Hearings on S. 754, H.R. 7873, H.R. 207, H.R. 658, H.R. 687, H.R. 773, and H.R. 4807 Before the Subcomm. on Crime of the H. Comm. on the Judiciary*, 93d Cong. 2000 (1974) (exhibit to the testimony of W. Vincent Rakestraw, Assistant Att'y Gen.), *as reprinted in* PARTRIDGE, *supra* note 151, at 117.

156. *See* United States v. HSBC Bank USA, N.A., 863 F.3d 125 (2d Cir. 2017); United States v. Fokker Servs. B.V., 818 F.3d 733 (D.C. Cir. 2016).

157. United States v. HSBC Bank USA, N.A., No. 12-CR-763, 2016 WL 347670 (E.D.N.Y. Jan. 28, 2016).

158. *HSBC Bank*, 863 F.3d at 142.

159. *See id*. at 133.

160. *Id.* at 136-38.

settled understandings about the independence of the Executive with regard to charging decisions."[161]

The Second Circuit's narrow construction of judicial authority echoes the D.C. Circuit's opinion in *United States v. Fokker Services*,[162] which involved an aerospace company that violated U.S. economic sanctions. In *Fokker*, the district court refused to approve a proposed DPA, concluding that the defendant had been "prosecuted so anemically for engaging in such egregious conduct for such a sustained period of time" that it would "promote disrespect for the law."[163] The D.C. Circuit construed this refusal to turn on the government's "fail[ure] to prosecute any 'individuals . . . for their conduct.'"[164] It then held that by refusing to grant the speedy-trial exclusion because it disagreed with the government's decision not to charge individuals the district court exceeded its authority under § 3161(h)(2).[165]

Absent judicial review, the Justice Manual is the primary constraint on prosecutors. In September 2015, Deputy Attorney General Sally Yates began an effort to refocus DOJ's resources on individual prosecutions. Her memo stated that "[o]ne of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing."[166] The memo required that "[t]o be eligible for <u>any</u> cooperation credit, corporations must provide to the Department all relevant facts about the individuals involved in corporate misconduct"[167] and that "[a]bsent extraordinary circumstances, no corporate resolution will provide protection from criminal or civil liability for any individuals."[168]

Strong language notwithstanding, commentators have questioned the efficacy of this policy statement.[169] Just one week after the policy's announcement,

161. *Id.* at 138 (quoting *Fokker Servs.*, 818 F.3d at 738).

162. 818 F.3d 733 (D.C. Cir. 2016).

163. United States v. Fokker Servs. B.V., 79 F. Supp. 3d 160, 167 (D.D.C. 2015), *vacated and remanded*, 818 F.3d 733.

164. *Fokker Servs.*, 818 F.3d at 740 (quoting *Fokker Servs.*, 79 F. Supp. 3d at 166).

165. *Id.* ("By rejecting the DPA based primarily on concerns about the prosecution's charging choices, the district court exceeded its authority under the Speedy Trial Act.").

166. Yates Memo, *supra* note 17, at 1.

167. *Id.* at 3.

168. *Id.* at 5.

169. *See, e.g.*, Brandon L. Garrett, *The Metamorphosis of Corporate Criminal Prosecutions*, 101 VA. L. REV. ONLINE 60, 72 (2016) ("It is not altogether clear that it is in fact a new policy."); Elizabeth E. Joh & Thomas W. Joo, *The Corporation as Snitch: The New DOJ Guidelines on Prosecuting White Collar Crime*, 101 VA. L. REV. ONLINE 51, 59 (2015); Daniel P. Chung, *Individual Accountability for Corporate Wrongdoing*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept.

the U.S. Attorney's Office for the Southern District of New York announced a DPA with General Motors in a case involving defective ignition switches.[170] No individuals were charged, despite various references in the settlement's statement of facts to specific individuals' knowledge of the ignition switch defects.[171] This underscores that DOJ policy statements and internal procedures remain, ultimately, nonbinding guidance for prosecutors. Absent an applicable statute or a binding regulation, nothing prevents DOJ leadership from approving a weak settlement when it perceives that doing so would be politically expedient.

2. *Why Do Corporate Settlements Generate Relatively Few Individual Prosecutions?*

While recent years have seen some prosecutions of natural persons charged with white-collar crimes—such as those hedge-fund traders and corporate insiders prosecuted by the Southern District of New York for insider trading—few emerged from investigations of TBTF companies. Judge Jed Rakoff has argued that this record is historically anomalous and is troubling as matters of both strategy and justice.[172] Since corporate criminal liability under federal law relies on respondeat superior, all corporate criminal charges must be premised on at least the possibility of an individual criminal charge for the same offense. So why have so few of the negotiated criminal settlements with TBTF firms been accompanied by prosecutions of culpable individuals?

21, 2015), https://corpgov.law.harvard.edu/2015/09/21/individual-accountability-for-corporate-wrongdoing [https://perma.cc/8QTN-3PZS].

170. U.S. Attorney's Office, S. Dist. of N.Y., *Manhattan U.S. Attorney Announces Criminal Charges Against General Motors and Deferred Prosecution Agreement with $900 Million Forfeiture*, U.S. DEP'T JUST. (Sept. 17, 2015), https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-criminal-charges-against-general-motors-and-deferred [https://perma.cc/8VZK-3PAP].

171. *See* Deferred Prosecution Agreement at 27, United States v. Gen. Motors Co., No. 1:15-cv-07342 (S.D.N.Y. Sept. 17, 2015), ECF No. 1-1, http://www.justice.gov/usao-sdny/file/772261/download [https://perma.cc/Q7L8-R2EN]; *see also* Joh & Joo, *supra* note 169, at 53 ("In the GM case . . . the DOJ charged only the corporation with fraud and false statements to regulators, even though the Information charging the corporation describes numerous acts by individuals that might have formed the basis for charges against them.").

172. *See* Rakoff, *supra* note 5 ("Just going after the company is . . . both technically and morally suspect. It is technically suspect because, under the law, you should not indict or threaten to indict a company unless you can prove beyond a reasonable doubt that some managerial agent of the company committed the alleged crime; and if you can prove that, why not indict the manager? And from a moral standpoint, punishing a company and its many innocent employees and shareholders for the crimes committed by some unprosecuted individuals seems contrary to elementary notions of moral responsibility.").

DOJ officials maintain that they would have prosecuted culpable individuals if they could have made the case.[173] Prosecutors may have lacked sufficient admissible evidence to prove these individuals' guilt beyond a reasonable doubt. In some cases, culpable individuals may be outside the jurisdiction of U.S. courts. And even when prosecutors can conceivably convict an individual, they might decline to indict for prudential reasons.[174] For instance, prosecutors may determine that it would be unjust scapegoating to prosecute a low-level employee on whom they have sufficient evidence because other, more senior company officials are truly culpable but somehow insulated from prosecution. Alternatively, prosecutors may decide that bringing an individual to trial is too expensive or too risky.

These explanations aside, commentators have critiqued the government, arguing that the dearth of individual cases reflects deeper injustices. On the one hand, representatives of big business have argued that relatively few culpable individuals are prosecuted because there were no crimes. Prosecutors wield such power over corporate defendants, they contend, that many settlements amount to extortion.[175] A pending criminal investigation generates legal costs, managerial distraction, and capital-market uncertainty sufficient to bring defendants to the negotiating table even before the government has presented definitive evidence of criminal conduct. On this account, the shortfall in individual prosecutions reflects the government's inability to find sufficient evidence to charge any

173. *See* Daniel C. Richman, *Corporate Headhunting*, 8 HARV. L. & POL'Y REV. 265, 269 (2014) ("Attorney General Holder has avowed: 'To the extent that we have the ability to bring cases against individuals or institutions, criminal charges, we will bring them.' On the way out the door, former Criminal Division Chief Lanny Breuer shook off criticism for not throwing Wall Street executives behind bars and echoed: 'If there had been a case to make, we would have brought it. I would have wanted nothing more, but it doesn't work that way.'").

174. *See id.* ("[T]he breadth and depth of federal criminal law have led us to expect and demand that prosecutors exercise judgment in the massive discretionary space that Congress has effectively delegated to them.").

175. *See, e.g.*, *The Criminalisation of American Business*, ECONOMIST (Aug. 28, 2014), https://www.economist.com/leaders/2014/08/28/the-criminalisation-of-american-business [https://perma.cc/GCX9-GJPF] ("[J]ustice should not be based on extortion behind closed doors. The increasing criminalisation of corporate behaviour in America is bad for the rule of law and for capitalism."); Richard A. Epstein, *The Deferred Prosecution Racket*, WALL ST. J. (Nov. 28, 2006, 12:01 AM), https://www.wsj.com/articles/SB116468395737834160 [https://perma.cc/3FZJ-57RQ] ("The agreements often read like the confessions of a Stalinist purge trial . . . ."); N. Richard Janis, *Deputizing Company Counsel as Agents of the Federal Government*, CATO INST. 4 (2008), https://object.cato.org/pubs/wtpapers/janis_deputizing.pdf [https://perma.cc/VU33-UY6G] ("[A corporate settlement] can be, and often is, a state-sponsored shakedown scheme in which corporations are extorted to pay penalties grossly out of proportion to any actual misconduct . . . . [P]ayment of tribute to the federal government [is] essentially a cost of doing business.").

individual, and DPAs reflect government abuse rather than corporate culpability.[176]

On the other hand, progressive critics have pointed to the revolving door between DOJ and the private sector to argue that business-friendly attorneys extend leniency to corporate criminals to curry favor with corporations and law firms they hope to join following their government service.[177] Indeed, many federal prosecutors worked at corporate law firms prior to their government service, and many return to the private white-collar defense bar after leaving DOJ.[178] During the Obama administration, many DOJ leaders had spun through the revolving door already. Notably, Attorney General Eric Holder, Assistant Attorney General for the Criminal Division Lanny Breuer, and many of Mr. Breuer's deputies had come to the government from the law firm Covington & Burling and returned there immediately afterward.[179] Critics have described a culture of deference to corporate defendants, an unwillingness to accept the risks of taking complex white-collar cases to trial, and an eagerness to settle, even if that meant forgoing cases against individuals.[180]

Even if DOJ leadership held this strategy, line prosecutors probably did not forego prosecution en masse to curry favor with future employers and clients. Compared to signing a settlement, prosecuting an executive at trial may be more prestigious experience for subsequent employment, particularly when high-stakes trial experience is increasingly rare among litigators. Moreover, many attorneys choose to work as federal prosecutors, seeking the increasingly rare opportunity to try high profile criminal cases. But careerism may push prosecutors to focus on obtaining large fines from corporate defendants rather than insisting on imposing structural-reform mandates or prosecuting individuals more aggressively. As trials disappear, firms may value experience with the DPA process above courtroom skills.[181] Personal risk aversion may push line prosecutors and

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176. *See, e.g.*, JESSE EISINGER, THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES, at xix-xxi (2017).

177. *See, e.g.*, Charles D. Weisselberg & Su Li, *Big Law's Sixth Amendment: The Rise of Corporate White-Collar Practices in Large U.S. Law Firms*, 53 ARIZ. L. REV. 1221, 1282 (2011). Some right-wing critics sound a similar note. *See, e.g.*, *Justice Inaction: The Department of Justice's Unprecedented Failure to Prosecute Big Finance*, GOV'T ACCOUNTABILITY INST. 23, http://g-a-i.org/wp-content/uploads/2012/08/DOJ-Report-8-61.pdf [https://perma.cc/M2E5-CUMD] ("Why would a government attorney interested in returning to a lucrative field throw his potential future clients in jail?").

178. *See* EISINGER, *supra* note 176, at 186-94; Weisselberg & Li, *supra* note 177, at 1282.

179. *See* EISINGER, *supra* note 176, at 189-90.

180. *Id.* at 197-98.

181. *Id.* at 198.

their bosses to focus on the predictable path to a DPA instead of investing time and money to prepare for a trial that may take weeks or even months to conclude and will place the government opposite well-resourced individual defendants.[182] Finally, a corporate settlement cannot be reversed on appeal, unlike individual convictions after trial.

These factors are consistent with the explanation that the government often proves unable to gather enough evidence to prosecute culpable individuals alongside corporations, but that does not suggest such evidence does not exist. Rather, the lack of evidence raises the question of whether the institutions used to investigate corporate crime and produce evidence usable for criminal trials are fit for the purpose. As Daniel Richman has noted, "particularly in the white-collar crime area . . . evidentiary strength is generally a function of prosecutorial effort, priorities, and institutional commitment."[183] Thus, the imbalance between corporate and individual prosecutions may reflect an inadequate investigative apparatus. The availability of virtually unreviewable settlements provides the government and TBTJ defendants with a way to terminate an investigation on mutually beneficial terms before uncovering sufficient evidence of individual guilt.

The possibility of concluding corporate criminal investigations via negotiated settlement exacerbates the TBTJ disincentive for genuine cooperation by lowering the amount of evidence required to successfully conclude a case. These resolutions may permit a form of tacit collusion[184] between headline-hungry prosecutors and executives eager to move on. Prosecutors may uncover evidence of wrongdoing but not know who specifically made key decisions, since responsibilities may be shared, records missing, and memories fuzzy. Corporate criminal liability may lie, even if there is no evidence to support charges against any particular individual, because "it may not matter under the law which of several possible executives or leaders in a chain of command approved of or authorized criminal conduct."[185] And since the settlements are never litigated, neither evidence nor charging theories are tested in court. But from the perspective of pub-

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182. *Id.*

183. Richman, *supra* note 173, at 269.

184. I am using the term "tacit collusion" in its microeconomics sense to refer to a situation where two parties, acting independently, find it individually rational to adopt the same strategies that they would if they were to actually collude. That is, rather than competing, the parties act in manner that is mutually beneficial but does not maximize social welfare.

185. Memorandum from Mark Filip, Deputy Att'y Gen., to Heads of Dep't Components, U.S. Att'ys 7 (Aug. 28, 2008), https://www.justice.gov/sites/default/files/opa/legacy/2008/08/28/corp-charging-guidelines.pdf [https://perma.cc/N7UJ-P3J4].

lic-choice theory, these settlements are valuable. Federal prosecutors, DOJ leadership, and the President can generate political capital from astronomical fines, and they may fulfill a mandate to crack down on corporate crime. Settlements also provide cash windfalls for elected prosecutors to dispense unilaterally[186] or opportunities to generate political chits.[187]

Corporate defendants also benefit from settlement. A settlement prevents further investigation of the company's affairs, which could expand both the corporation's and its executives' liability. A settlement also permits the company to negotiate over the public disclosure of information concerning its malfeasance. A defendant might agree to pay a higher fine to avoid making definitive admissions of guilt, disclosing the content of inculpatory communications, or revealing the identities of culpable executives. Such secrecy can also protect against civil liability, whether from shareholders, consumers, or crime victims.

If a defendant company (or its executives) has an incentive to obstruct government investigators—as TBTJ firms may—then the government's reliance on internal investigations may be exploited. Investigative firms may also adopt incurious postures where illegality is not immediately apparent, so as to increase their attractiveness to other corporations for future investigative work. This structural explanation does not require unethical lawyering. It is enough that culpable managers at a defendant firm successfully dissemble to corporate defense counsel, as some have been found to do.[188]

Defense counsel cannot investigate using the same tools as government agents. Prosecutors investigating a criminal conspiracy use leverage to extract information from subordinates and interview witnesses separately to create prisoners' dilemmas. But in the routine corporate-crime investigation, defense counsel conducts both the internal investigation and the defense effort, often organizing a joint defense agreement with individual employees.[189] Thus, prior to

186. *See, e.g.*, James C. McKinley Jr., *Cyrus Vance Has $808 Million to Give Away*, N.Y. TIMES (Nov. 6, 2015), https://www.nytimes.com/2015/11/08/nyregion/cyrus-vance-has-dollar-808-million-to-give-away.html [https://perma.cc/7ECM-Z4MM].

187. *See, e.g.*, David Kocieniewski, *In Testy Exchange in Congress, Christie Defends His Record as a Prosecutor*, N.Y. TIMES (June 26, 2009), https://www.nytimes.com/2009/06/26/nyregion/26christie.html [https://perma.cc/7N4G-Z9MA] (describing Chris Christie's conferral of a lucrative monitorship on John Ashcroft's firm).

188. *See, e.g.*, Alex Berenson, *Case Expands Type of Lies Prosecutors Will Pursue*, N.Y. TIMES (May 17, 2004), https://www.nytimes.com/2004/05/17/business/case-expands-type-of-lies-prosecutors-will-pursue.html [https://perma.cc/755E-TM3Z] (describing guilty pleas to obstruction-of-justice charges entered by executives of Computer Associates for lying to attorneys with Wachtell, Lipton, Rosen & Katz, which was conducting an internal investigation of the company).

189. *See* JUSTICE MANUAL, *supra* note 8, § 9-28.730.

meeting with prosecutors, employees likely know how other relevant employees have answered hard questions. Conspiracies are far more robust under conditions permitting coordination. Prosecutors are also more reluctant to use powerful investigative tools such as wiretaps, undercover recordings, or grand jury testimony in corporate-crime cases, compared to investigations of other types of complex conspiracies.[190] We may thus see prosecutors' reluctance to use the investigative tactics normally employed to unravel criminal conspiracies as the most troublesome form of deference to corporate-crime defendants, because it insulates both individuals and institutions from responsibility for wrongdoing.

If there is a revolving-door problem, it is excessive deference to the internal-investigation process, not a reluctance to charge individuals against whom there is ample evidence. Prosecutors might be eager to indict an executive if they had sufficient evidence, but acculturation to the internal-investigations business breeds attorneys who are familiar with its customs and respectful of its work product. Absent resources to independently investigate, prosecutors welcome an internal investigation's findings. Prepackaged conclusions inculpating the corporation may be enough to satisfy some prosecutors, even if the internal investigations would not support charges against any individuals.

B. A Proposal for Reform

The Constitution exclusively vests prosecutorial discretion in the executive branch. But Congress can improve corporate-crime control by shifting the statutory framework within which prosecutors operate by introducing action-forcing procedures. Provided the statutory authority, federal courts could supervise prosecutors more closely and ensure that negotiated settlements serve the public interest. Finally, transparency requirements can enlist the press in maintaining accountability for corporate criminal prosecutions and companies' structural reforms.

This Section presents a legislative proposal that would introduce binding procedural requirements on DOJ's use of DPAs to resolve corporate criminal investigations. DPAs have shifted from an exceptional pretrial diversion tool to the norm. Thus, the DPA Procedures Act would authorize more searching judicial review of DPAs, ban unreviewable nonprosecution agreements, structure prosecutorial decision-making, mandate transparency, and create a new office within DOJ to develop expertise in structural reforms. Some provisions add procedural protections for defendant firms. Others are intended to be action-forcing requirements to push prosecutors to improve investigative strategy. And others are intended to increase political accountability of the government's crime control

190. *See* EISINGER, *supra* note 176.

strategies. The full text of this model bill is presented in Appendix B. The following Sections explain the operation of and rationale for the bill's key provisions.

1. *Strengthening Judicial Review of Deferred Prosecution Agreements*

The current legal framework for DPAs provides defendants with few enforceable rights and requires minimal transparency from DOJ. As Section VI.A.1 explained, the D.C. and Second Circuits have declined to read § 1361(h)(2) of the Speedy Trial Act as authorizing any meaningful judicial review of a corporate DPA's substance.[191] Since both the TBTJ dynamic and the DPA's role are well established, Congress should put corporate DPAs on a sounder statutory footing. Several judges have already called for Congress to authorize judicial review of corporate DPAs.[192] The legislative proposal laid out in Appendix B would establish a robust framework for judicial review of corporate DPAs. It aims both to protect defendants from inadequate prosecutions and to induce prosecutors to reach settlements that would better prevent corporate crime.

The DPA Procedures Act would establish a mandatory process for judicial approval of DPAs where the defendant is an organization.[193] It requires that prosecutors publicly file all DPAs with a competent district court and include in that filing a charging document articulating the theory of liability, a statement of facts to support those charges, a written agreement stating all penalties and reform mandates, and a statement from the prosecutor explaining why she decided to resolve the case with a DPA and how the proposed agreement serves the public interest.[194] The Act would authorize the court to make a two-pronged inquiry: first, whether the charging document and statement of facts sufficiently state a

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191. *See supra* Section IV.A.1; *see also* United States v. HSBC Bank USA, N.A., 863 F.3d 125, 138 (2d Cir. 2017) (declining to "interpret that provision's vague 'approval' requirement as imbuing courts with an ongoing oversight power over the government's entry into or implementation of a DPA"); United States v. Fokker Servs. B.V., 818 F.3d 733, 738 (D.C. Cir. 2016) (finding that "the Act confers no authority in a court to withhold exclusion of time pursuant to a DPA based on concerns that the government should bring different charges or should charge different defendants").

192. *See HSBC Bank*, 863 F.3d at 143 (Pooler, J., concurring) ("I respectfully suggest it is time for Congress to consider implementing legislation providing for such review."); United States v. Saena Tech Corp., 140 F. Supp. 3d 11, 30 n.9 (D.D.C. 2015) ("[C]ongressional action to clarify the standards a court should apply when confronted with a corporate deferred-prosecution agreement may be appropriate.").

193. *See infra* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(a); *see also id.* § 1(b)(1) (defining "Defendant" to restrict the Act's application to business organizations).

194. *Id.* § 1(d) ("Form of Agreement").

theory of corporate criminal liability; and second, whether approval serves the public interest.[195] In determining whether to approve the agreement, the court would be empowered to conduct some limited fact-finding, and the defendant would be able to challenge weaknesses in the government's theory of the case, requiring the government to put forward sufficient evidence to support its claims.[196] Finally, if the government alleged that the defendant had breached its obligations, the court would supervise the agreement's termination.[197]

Judicial review should induce prosecutors to amass sufficient evidence to prosecute culpable individuals alongside corporations. The Act would require the court to ensure that the DPA set forth a charging theory with sufficient legal and factual support to satisfy a motion-to-dismiss inquiry.[198] Since a sufficient corporate charge would require a plausible respondeat superior theory, these procedures would ensure prosecutors identify at least one culpable individual prior to achieving the political benefit of a corporate prosecution. And since the Act empowers defendants to compel the government to adduce factual support,[199] prosecutors would have to accrue some evidence of malfeasance by responsible individuals. The Act leaves courts to define the public-interest inquiry through federal common law. Garrett has explained how a court might do so by considering ten factors: adequacy of financial penalties, imposition of compliance terms, monitoring, cooperation with law enforcement, substantive law, collateral consequences, harm caused to victims and the public, government interests, delay, and informing the public.[200] Whether courts should adopt all of these factors is beyond the scope of this Note, but suffice it to say that courts have the capability and tools to conduct the Act's public-interest inquiry.

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195. *Id.* § 1(e) ("Judicial Approval").

196. *Id.* § 1(f) ("Procedure for Judicial Approval").

197. *Id.* § 1(j) ("Terminating the Agreement").

198. Federal Rule of Criminal Procedure 12(b)(3)(B)(v) permits a defendant to move for dismissal of a criminal indictment for failure to state an offense, but courts have employed a lenient standard in reviewing an indictment's sufficiency. *See* Hamling v. United States, 418 U.S. 87, 117-18 (1974). While the Act does not propose a precise legal test for a DPA's sufficiency, the procedures would only achieve their purposes if district courts applied a more rigorous review, akin to the plausibility test used in the civil motion-to-dismiss context. *See* Ashcroft v. Iqbal, 556 U.S. 662, 678-79 (2009); *cf.* James M. Burnham, *Why Don't Courts Dismiss Indictments?: A Simple Suggestion for Making Federal Criminal Law a Little Less Lawless*, 18 GREEN BAG 2D 347, 357-58 (2015) (arguing for the application of the civil plausibility test in the criminal context).

199. For a more detailed description of the factual-support requirements, see *infra* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(f)(2) ("Procedure for Judicial Approval").

200. *See* Brandon L. Garrett, *The Public Interest in Corporate Settlements*, 58 B.C. L. REV. 1483, 1525-36 (2017).

Bearing this burden, prosecutors should be less willing to rely solely on investigations that find general corporate wrongdoing without identifying specific, culpable individuals. The prospect of judicial review should encourage prosecutors both to exert continuous pressure on internal investigations prior to extending cooperation credit and to conduct more genuine, independent investigations themselves. Prosecutors could still satisfy the judicial-review procedure with evidence far short of that required to bring a complex white-collar criminal case to trial and win before a jury. But the Act would forestall political victory until there is at least *some* evidence of individual wrongdoing. The idea is to put DOJ attorneys in a better position to prosecute individuals at the point where a corporate settlement is possible.

This approach activates the judiciary's oversight capacity without violating the separation-of-powers concerns aired by the *HSBC* and *Fokker Services* courts. Both *HSBC* and *Fokker Services* turned on statutory holdings, which found that Congress had not clearly authorized substantive judicial review of corporate DPAs in the Speedy Trial Act. Under the approach taken in the DPA Procedures Act, the judiciary would be unable to compel prosecutors to file charges. Thus, it avoids the separation-of-powers limit that the *Fokker Services* court identified.[201] To the contrary, separation-of-powers concerns support adding procedures: by relying on DPAs in corporate criminal prosecutions, the executive has arrogated a power that combines elements of criminal and regulatory authority, then claimed it as unreviewable. John C. Coffee described prosecutors as having "something close to absolute power" when negotiating corporate criminal settlements.[202] It would render the judiciary a rubber stamp to say, as a matter of constitutional law, that Congress may permit the executive to obtain judicial imprimatur for its preferred resolution of a criminal case but may not mandate judicial review of the charges' legal and factual sufficiency.

Courts have been called on to prevent collusive settlements in other circumstances. At the same time that Congress was working on the Speedy Trial Act, it was also considering the problem of collusive settlements between the DOJ Antitrust Division and politically powerful businesses. The resulting Tunney Act is still in force today. It requires that courts considering an antitrust consent decree determine whether "the entry of such judgment is in the public interest."[203] In requiring the court to make an independent public-interest appraisal of antitrust

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201. *See* United States v. Fokker Servs. B.V., 818 F.3d 733, 743-44 (D.C. Cir. 2016).

202. John C. Coffee, Jr., *Deferred Prosecution: Has It Gone Too Far?*, NAT'L L.J., July 25, 2005, at 13, 13.

203. 15 U.S.C. § 16(e)(1) (2018); *see also* Antitrust Procedures and Penalties Act, Pub. L. No. 93-528, § 2, 88 Stat. 1706, 1707 (1974) (codified as amended at 15 U.S.C. § 16 (2018)) (enacting the public-interest requirement of § 16).

consent decrees, Congress was concerned that settlement terms were inappropriately affected by lobbying and political considerations since most defendants in antitrust cases are large, politically powerful corporations.[204] Federal Rule of Civil Procedure 23 also seeks to prevent binding absent class members with a collusive settlement through an independent judicial appraisal of fairness, reasonableness, and adequacy.[205] And when the U.K. Parliament decided to introduce corporate DPAs by statute, it required that courts conduct two separate hearings and determine that "the proposed terms of the DPA are fair, reasonable and proportionate."[206]

At least one bill that would have expressly authorized judicial review has already died in committee.[207] The Accountability for Deferred Prosecution Act of 2014 would have required the Attorney General to issue "written guidelines" for the Department's use of DPAs and provided that a reviewing court "shall approve the agreement if the court determines the agreement is consistent with the guidelines for such agreements and is in the interests of justice."[208] In essence, this Act would have permitted DOJ to establish its own rules for DPAs while giving courts the power to police prosecutorial compliance with the rules. However, this Act would not have clearly authorized courts to inquire into whether a proposed agreement would serve the public interest or whether the charging document and statement of facts sufficiently supported a theory of corporate criminal liability.

In contrast, my proposed model legislation would require prosecutors to file a public-interest statement, which courts could take into account. This public-interest statement, modeled on the Tunney Act's competitive-impact-statement provision,[209] would focus the court's inquiry, maintain the executive's primacy by providing an explanation subject to judicial deference, and inform the public why each settlement is structured as it is. As in the antitrust context, the statement's preparation itself has benefits for the public interest, because a mandate to publicly justify a settlement's provisions will focus government negotiators

204. *See* Lawrence M. Frankel, *Rethinking the Tunney Act: A Model for Judicial Review of Antitrust Consent Decrees*, 75 ANTITRUST L.J. 549, 552 (2008); *see also* John J. Flynn & Darren Bush, *The Misuse and Abuse of the Tunney Act: The Adverse Consequences of the "Microsoft Fallacies*,*"* 34 LOY. U. CHI. L.J. 749, 755-57 (2003) (describing the appearance of corruption in the Nixon DOJ's consent decree with International Telephone & Telegraph Corp.).

205. FED. R. CIV. P. 23(e)(2).

206. Crime and Courts Act 2013, c. 22, § 45, sch. 17.7(1)(b), http://www.legislation.gov.uk/ukpga/2013/22/enacted [https://perma.cc/HB72-UB8R].

207. *See* Accountability in Deferred Prosecution Act of 2014, H.R. 4540, 113th Cong. (2014).

208. *Id.* §§ 4(a), 7(a).

209. *See* Antitrust Procedures and Penalties Act, 15 U.S.C. § 16(b) (2018).

on ensuring that the DPA remediates the root causes of the particular unlawful conduct and deters future criminality within the organization.

While DOJ would certainly oppose these constraints, the Act is designed to solicit support from the business lobby. Defendants have long argued that DPAs permit DOJ to extort companies without viable legal theories or sufficient factual proof of wrongdoing.[210] The Act would provide companies with a means of defending themselves in court from DPAs that lack a sufficient legal and factual underpinning.[211] By precluding other prosecutions, the Act would also address the problem that negotiated settlement agreements can leave defendant firms liable to prosecution in other jurisdictions, including by other actors within DOJ.[212] It would also provide defendants with judicial protection from a DPA's termination.[213] Finally, companies subject to DPAs would have recourse to the court to enforce regulations regarding the conduct of any independent monitors, a right that can help contain costs and prevent some intrusive behavior.[214]

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210. *See, e.g.*, Paul Larkin, *The Problematic Use of Nonprosecution and Deferred Prosecution Agreements to Benefit Third Parties*, HERITAGE FOUND. (Oct. 23, 2014), https://www.heritage.org/report/the-problematic-use-nonprosecution-and-deferred-prosecution-agreements-benefit-third-parties [https://perma.cc/H7PR-G7TZ].

211. *See infra* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(e) ("Judicial Approval").

212. *See id.* § 1(g) ("Effect of Agreement"); *cf.* Materials on Nonprosecution Agreement Between the U.S. Department of Justice, Criminal Division, Fraud Section, the Eastern District of New York, and JPMorgan Securities (Asia Pacific) Ltd. 6, https://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/jpmorgan-securities-asia-pacific.pdf [https://perma.cc/3FJ5-CKTB] ("This Agreement is binding on the Company, JPMC, and the Offices but specifically does not bind any other component of the Department of Justice, [or] other federal agencies . . . ."). *But see* JUSTICE MANUAL, *supra* note 8, § 1-12.100 (emphasizing that, in investigations involving multiple DOJ components, DOJ attorneys "should remain mindful of their ethical obligation not to use criminal enforcement authority unfairly to extract, or to attempt to extract, additional civil or administrative monetary payments").

213. *See infra* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(j) ("Terminating the Agreement"); *cf.* Materials on Deferred Prosecution Agreement Between the Office the Southern District of New York and General Motors Co. 11, https://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/gm.pdf [https://perma.cc/A35Y-7PJR] (giving the U.S. Attorney's Office "sole discretion" to rescind the DPA upon determining a violation occurred).

214. *See infra* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(h) ("Conduct of Monitors").

2. *Prohibiting Corporate Nonprosecution Agreements*

Effective judicial review requires that Congress prohibit prosecutors from entering into nonprosecution agreements (NPAs) and other forms of negotiated settlement that bypass the courts and "escape judicial review entirely."[215] So long as prosecutors can freely choose to obtain the benefits of a DPA without any review, courts will struggle to develop a robust supervisory jurisprudence.[216] For that reason, functional alternatives to DPAs must be prohibited.

NPAs are contracts between a particular prosecutor and a defendant corporation that formalize the prosecutor's decision not to bring charges in exchange for a financial penalty and other terms. "[F]ormal charges are not filed and the agreement is maintained by the parties rather than being filed with a court."[217] Judicial approval is not involved; prosecutors just issue a press release, an NPA letter, and a statement of facts.[218] NPAs are widely viewed as less punitive than DPAs, and the lack of criminal charges "giv[es] a small public relations benefit to the company, which can truthfully assert it was never prosecuted for the misconduct."[219] Also unlike DPAs, NPAs lack any statutory basis: DOJ relies on its inherent authority to exercise prosecutorial discretion.

Prosecutors are still finding new applications for unreviewable NPAs. In April 2016, the DOJ Criminal Division announced the FCPA pilot program, under which firms that self-reported unlawful payments and cooperated with the government could qualify for a process described as "declinations with disgorgement," in which the Department declines to bring charges and the company disgorges associated profits.[220] This "presumption that the [self-reporting and cooperating] company will receive a declination absent aggravating circumstances"

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215. Garrett, *supra* note 200, at 1511.

216. *See* Gordon Bourjaily, Note, *DPA DOA: How and Why Congress Should Bar the Use of Deferred and Non-Prosecution Agreements in Corporate Criminal Prosecutions*, 52 HARV. J. ON LEGIS. 543, 565-66 (2015).

217. Memorandum from Craig S. Morford, Acting Deputy Att'y Gen., to Heads of Dep't Components, U.S. Att'ys 1 n.2 (Mar. 7, 2008), https://www.justice.gov/sites/default/files/dag/legacy/2008/03/20/morford-useofmonitorsmemo-03072008.pdf [https://perma.cc/5KT7-6WBX].

218. *See, e.g.*, Materials on Nonprosecution Agreement Between the Southern District of New York and Ernst & Young LLP, *supra* note 43.

219. United States v. HSBC Bank USA, N.A., No. 12-CR-763, 2013 WL 3306161, at *5 n.7 (E.D.N.Y. July 1, 2013) (quoting Peter J. Henning, *The Organizational Guidelines: R.I.P.?*, 116 YALE L.J. POCKET PART 312, 314 n.9 (2007)).

220. Karen Woody, *"Declinations with Disgorgement" in FCPA Enforcement*, 51 U. MICH. J.L. REFORM 269, 270-71 (2018); *see* Andrew Weissmann, *The Fraud Section's Foreign Corrupt Practices Act Enforcement Plan and Guidance*, CRIMINAL DIV., U.S. DEP'T JUST. (2016), https://www.justice has subsequently been formalized in the Justice Manual.[221] The pilot program's goals were to "deter individuals and companies from engaging in FCPA violations in the first place, encourage companies to implement strong anti-corruption compliance programs to prevent and detect FCPA violations, and . . . increase the Fraud Section's ability to prosecute individual wrongdoers whose conduct might otherwise have gone undiscovered or been impossible to prove."[222] The first two companies to obtain declinations with disgorgement received them via NPAs.[223]

Prohibiting DOJ from entering into NPAs requires legislation. To avoid prohibiting other forms of declinations, the ban should target the core issue: declinations issued to business organizations in exchange for money. Section 2 of the DPA Procedures Act would ban corporate NPAs while maintaining DOJ's authority to enter court-supervised DPAs, issue no-action letters, and publish guidance in the form of advisory opinions or nonenforcement policies.[224] The Act does not pose separation-of-powers concerns because prosecutors retain the unreviewable discretion to decline to charge any defendant. Nor would the statute dictate when prosecutors should bring charges or what factors they should consider.[225] This statute would regulate prosecutors' exercise of that discretion, prohibiting them from using a species of private contract to obtain large payments as consideration for declining prosecution.[226] It would recognize that NPAs have become an important means of imposing criminal sanctions beyond any judicial supervision. Compelling prosecutors to submit negotiated corporate criminal settlements to a court thus reintroduces a separation of powers into this area of criminal practice.

.gov/archives/opa/blog-entry/file/838386/download [https://perma.cc/66VV-M4JT]; *see also supra* note 120 and accompanying text.

221. JUSTICE MANUAL, *supra* note 8, § 9-47.120.

222. Weissmann, *supra* note 220, at 2.

223. These companies were Nortek Inc. and Akamai Technologies. *See SEC Announces Two Non-Prosecution Agreements in FCPA Cases*, U.S. SEC. & EXCHANGE COMMISSION (June 7, 2016), https://www.sec.gov/news/pressrelease/2016-109.html [https://perma.cc/U3TK-272X].

224. The statutory language is modeled on a proposal in a student note in the *Harvard Journal on Legislation*. *See* Bourjaily, *supra* note 216, at 566 (proposing a similar statute to prohibit NPAs).

225. *See id.*

226. *Id.*

3. *Improving Structural-Reform Mandates and Increasing Political Accountability for Law Enforcement Strategy*

"Structural-reform prosecutions" use the leverage achieved from charging an entire organization to compel adoption of substantial internal reforms.[227] A common critique of structural-reform prosecutions is that prosecutors do not know how to run a business or rebuild failing internal controls. Federal prosecutors usually *do* lack such expertise. Moreover, prosecutors employ structural-reform mandates in an ad hoc manner, since "DOJ . . . has not adopted genuine standards governing what mandates to impose."[228] This, along with the lack of judicial oversight, has led some commentators to argue that structural-reform prosecutions operate in ways that are "inconsistent with the rule of law."[229] Others believe that the efficacy of such mandates is an open question.[230] This Note shows why fines alone may not incentivize TBTJ companies to restructure profitable businesses.[231] Once a company has demonstrated disrespect for the law, it is sensible to subject it to more intrusive supervision than law-abiding competitors face under generally applicable law, particularly where fines alone may not induce sufficient internal policing. The DPA Procedures Act would encourage structural reforms by making them more rigorous, fair, and transparent.

Currently, DOJ attorneys lead prosecutions, handle settlement negotiations, and maintain ongoing responsibility pending DPAs. They implement and supervise structural-reform mandates without supervision from the courts.[232] This decentralization stymies institutional learning by doing. Anecdotal evidence also suggests that, in practice, line prosecutors spend little time and effort monitoring DPA implementation because they are focused on building new cases.

The Act would create a DOJ Office of Corporate Reform to centralize design and administration of structural reforms.[233] This Office would consult with

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227. *See* Garrett, *supra* note 18, at 855.

228. Arlen & Kahan, *supra* note 73, at 327.

229. Jennifer Arlen, *Prosecuting Beyond the Rule of Law: Corporate Mandates Imposed Through Deferred Prosecution Agreements*, 8 J. LEGAL ANALYSIS 191, 192 (2016).

230. *See* Garrett, *supra* note 18.

231. *See supra* Section VI.A.1.

232. *See* Garrett, *supra* note 18, at 933-34 ("Where courts do not narrow the meaning of [broad, ill-defined] statutes, prosecutors fix their meaning in practice, so that in effect the legislature has delegated common-law crime-making authority to prosecutors.").

233. *See infra* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(i)(1).

prosecutors during DPA negotiations and monitor subsequent implementation.[234] Centralizing responsibility would permit the Office's dedicated team of attorneys and compliance professionals to gain experience in designing and implementing structural-reform programs tailored to the specific industries and crimes that are repeat subjects of DPAs. It echoes a limited effort undertaken by the Fraud Section in 2015, when it hired a compliance expert.[235] Because the Office would have the discretion to find a company in breach of its DPA obligations, the Office is properly located in DOJ rather than in a sectoral regulator. However, the statute would require the Office to collaborate with sectoral regulators in developing and supervising structural reforms, since these regulators have more experience with defendants and the needs of regulated industry.[236] Simultaneously, the Act expands due process by requiring DOJ to issue regulations governing monitors' conduct and costs and by requiring courts to supervise monitors and hear firms' objections.[237]

Centralizing structural reforms could make corporate prosecution a more effective steward of the public interest when several companies are prosecuted for similar crimes. For instance, from 2010 to 2017, at least thirty global banks were penalized for assisting customers who were subject to U.S. economic sanctions to move money illegally.[238] Had a centralized unit designed and overseen compliance reforms, it could have gained meaningful experience in repairing broken internal controls. Yet these cases were likely handled by many different prosecutors in numerous U.S. Attorneys' Offices and Main Justice. Certainly, these cases received coordinated attention at the highest levels of the Department,[239] but that does not necessarily mean that lessons were being learned, shared, and systematically employed across cases or across offices. And what little is publicly known about the banks' implementation of reforms is troubling, in that it reveals substantial resistance within firms subject to DPAs. For instance, in 2015, HSBC's independent monitor, installed pursuant to the 2012 money-laundering and sanctions-evasion DPA, reported that his interactions with senior managers

234. *See id.* § 1(i).

235. *See New Compliance Counsel Expert Retained by the DOJ Fraud Section*, U.S. DEP'T JUST. (Nov. 3, 2015), https://www.justice.gov/criminal-fraud/file/790236/download [https://perma.cc/E6FJ-EQMQ].

236. *See infra* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(i)(4).

237. *See id.* § 1(h).

238. *See Fines for Banks That Breached U.S. OFAC Sanctions*, THOMSON REUTERS (2017), https://www.refinitiv.com/content/dam/gl/en/documents/infographics/fines-for-banks-that-breached-us-sanctions-infographic.pdf [https://perma.cc/XP3T-HWN5].

239. *See* EISINGER, *supra* note 176 (describing prosecutors' frustration with the degree of managerial control from political appointees).

were "marked by combativeness," as the managers "inappropriately pushed back against adverse findings" by the auditors and "resisted" in a way that "demonstrated a deficient culture that had not fully accepted the role and legitimacy of . . . [a]udit and control functions."[240]

Transparency could also enhance accountability for DOJ's corporate-crime agenda. The Act would make public access to independent monitors' reports a default DPA term.[241] Currently, the public knows relatively little about reforms in companies subject to multiple rounds of investigation and settlement. But corporate conduct and government are matters of intense public concern. Structural reforms are generally confidential, and DOJ has not publicly reviewed whether its agreements have effectively reformed defendant institutions.[242] While prosecutors trumpet settlements in press releases, they often fail to disclose the operative legal text of settlements to the public. One study found that from 2012 to 2014, less than thirty-five percent of DOJ's press releases announcing corporate settlements provided access to the underlying legal documents,[243] and the best publicly accessible database of corporate criminal settlements is operated by the University of Virginia Law Library, not the government.[244] Even summarized or redacted versions of monitors' reports would assist the press in holding companies and prosecutors to account for their responses to corporate crime. Greater access to the text of settlements would also allow researchers to better determine what works for deterrence and what doesn't, giving prosecutors a more effective tool kit for engaging with TBTJ firms.

Opacity also prevents the public from determining a settlement's true costs. Press releases can aggregate fines, penalties, disgorgement, restitution, and cost figures associated with in-kind actions, such as a bank's agreement to offer mortgage modifications to borrowers improperly sold predatory loans. But unless a settlement agreement expressly labels the payment a "fine" or a "penalty," or prohibits the firm from claiming a tax deduction, companies may claim some

240. Letter from Loretta E. Lynch, U.S. Att'y, E. Dist. N.Y., to Judge John Gleeson, U.S. Dist. Court, E. Dist. of N.Y. at 3, United States v. HSBC Bank USA, N.A., No. 12-763 (E.D.N.Y. Apr. 1, 2015), ECF No. 33.

241. *See infra* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(h)(1)(C).

242. *See* Garrett, *supra* note 18.

243. Phineas Baxandall & Michelle Surka, *Settling for a Lack of Accountability?: Which Federal Agencies Allow Companies to Write Out-of-Court Settlements as Tax Deductions, and Which Are Transparent About It*, U.S. PUB. INT. RES. GROUP EDUC. FUND 13 fig.1 (Dec. 2015), https://uspirg.org/sites/pirg/files/reports/USPIRG_SettlementsReport.pdf [https://perma.cc/C7QW-FC9U].

244. *See Corporate Prosecution Registry*, U. VA. L. LIBR., http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry [https://perma.cc/4VYA-JTPD].

settlement costs as deductible business expenses, shifting a fiscal burden onto the public sector and diluting the settlement's deterrent value.[245] Thus, the Act includes provisions modeled on the Truth in Settlements Act of 2017 to require DOJ to break out those payments that each settlement agreement expressly designates as not tax deductible.[246]

Today, DPAs permit tacit collusion between prosecutors and TBTJ defendants, but they also enable the government to respond flexibly to complex corporate crimes. Procedural regularity and political accountability are overdue. The Act would divide supervision among the executive branch, the judiciary, and civil society. It is not intended to prevent settlements or force prosecutors to take corporate defendants, whether individuals or firms, to trial. Rather, it seeks to ensure that an administration cannot generate political capital through prosecutions unless it effectively addresses the root causes of corporate crime, so that corporate criminal prosecution is not just a form of rent extraction but an effective deterrent.

CONCLUSION

This Note uses economic formalism to make an intuitive point: if an organization and its managers decide "rationally" to undertake a course of criminal conduct, and if they know a priori that the state is constrained in how severely it can punish them, then they will be underdeterred relative to the ideal. This economic analysis recognizing the size, interconnectedness, and political power of some contemporary firms shows how the government's power to deter corporate crime breaks down in the context of a highly concentrated political economy. When TBTJ firms find that crime does pay under certain circumstances, the government will struggle to elicit good-faith cooperation against culpable individuals. But the government's investigative strategy relies heavily on cooperation and self-reporting. This Note recasts the relative dearth of individual prosecutions as a consequence of corporate power and a government strategy made overly deferential in the name of efficiency. The weaknesses of this strategy help explain how an era of aggressive corporate criminal prosecution has coincided with successive waves of criminality among certain large corporations.

In response, DOJ could focus more intently on bringing individual prosecutions in order to both rely less on internal investigations to generate evidence

245. *See generally* Baxandall & Surka, *supra* note 243 (questioning the deterrent value of such settlements and noting that, as a result of them, the public may endure higher taxes, cuts to funding for public programs, and increased national debt).

246. *Compare* Appendix B, Deferred Prosecution Agreement Procedures Act § 1(k) ("Transparency"), *with* Truth in Settlements Act of 2017, S. 1145, 115th Cong. (2017).

and to craft more effective structural-reform mandates. But as a political strategy, this is limited. This methodological point is unlikely to make headway with an administration reluctant to prosecute white-collar crime. And for administrations with a popular mandate to address the problem of corporate crime, the relatively quick political victories of multibillion-dollar settlements achieved through the usual "cooperative" means may prove too alluring to pass up. A legislative reform introducing binding procedural requirements and meaningful judicial review aims for a more structural fix. It would reinvigorate the separation of powers in the area of corporate criminal law, insulate defendants from prosecutorial pressure tactics, and require prosecutors to generate evidence against specific individuals as a prerequisite to the political payoff of a corporate settlement. Ultimately, these problems are pathological consequences of our highly concentrated political economy and therefore beyond prosecutors' power to resolve. But so long as the government treats some corporations as TBTJ, it should not rely on corporate fines alone to manage their criminal conduct.

APPENDIX A: MATHEMATICAL APPENDIX

1. *Additional Derivations Under Perfect Information*

With perfect information, the manager's contract can condition on verifiable effort. Building on (1), the risk-neutral manager's utility is

$$U = \omega + \mu(m+n) + E(n) - C(n,m) - P(n)\sigma[S_m + J(\pi)]. \quad (16)$$

The firm faces an *individual-rationality constraint* on the contract, $U \geq k$, where k is the manager's best outside option. The firm chooses effort levels to balance the private benefit accruing from socially harmful activity, the disutility of effort, and the expected sanction when the manager is caught committing a crime. Substituting equation (16) into equation (2) and assuming that the individual-rationality constraint binds, the profit function is

$$B = (m+n) + E(n) - C(n,m) - P(n)\sigma\left(S_f + S_m + J(\pi)\right) - k. \quad (17)$$

The first-order conditions are

$$B_m = 1 - C_m = 0 \quad (18)$$

$$B_n = 1 + E_n - C_n - P_n(n)\sigma\left[S_f + S_m + J(\pi)\right] = 0. \quad (19)$$

The second-order conditions for a maximum hold because $C_{mn}, C_{mm}, C_{nn} > 0; E_{nn} < 0; and\ P_{nn} \geq 0$. These conditions can be solved for optimum effort levels $\langle m^*, n^* \rangle$ as functions of criminal law policy $\langle \sigma, S_f, S_m, \pi \rangle$ and the parameters of the E, C, and P.

Rearranging (3), the government's objective function becomes

$$W = (m+n) + E(n) - C(n,m) - P(n)[H + D(\pi)] - k. \quad (20)$$

Following Garoupa, align the firm's profit function with the government's social-welfare function and rearrange to find the optimal enforcement strategy[247]:

$$S_f + S_m + J(\pi) = \frac{H + D(\pi)}{\sigma}. \quad (21)$$

To fully internalize the harms created by exerting antisocial effort, the sum of the fines and the monetary equivalent of the expected disutility of incarceration should equal the sum of social harm and incarceration cost, weighted by the probability of conviction. Since both the firm and the manager are risk neutral, there are no information asymmetries, and complete contracts are possible, the division of the fine between corporate and individual liability is irrelevant.

247. Garoupa, *supra* note 64, at 246.

Following Becker's argument that fines are socially preferable sentences to imprisonment because the former is a costless transfer that can compensate victims and the latter is costly, fines should be maximal before sentencing a defendant to prison.[248] That is,

$$\text{if } \pi > 0, \text{ then } S_f + S_m = \bar{W} + \xi. \qquad (22)$$

2. Derivation Under Moral Hazard

Section III.B assumed that firms have perfect information about managerial effort, but few crimes are committed without concealment.[249] Thus, this Section will relax this assumption and follow Garoupa by introducing an information asymmetry. If neither the amount nor the nature of the manager's effort is observable within the firm, then employment contracts cannot condition on a precise output of effort and a first-best contract is impossible. Instead, the model adopts agency theory to design a risk-sharing employment contract that incentivizes the constrained-optimal exertion of antisocial effort. Expanding the expected punishment $\tau(n; \sigma, S_m, \pi)$ in equation (1), the manager's utility becomes

$$U = \omega + \mu(m + n) + E(n) - C(m, n) - P(n)\sigma[S_m + J(\pi)]. \qquad (23)$$

Assuming the manager follows standard utility-maximizing behavior, the first order conditions for his choice of effort are

$$U_m = \mu - C_m = 0 \qquad (24)$$

$$U_n = \mu + E_n(n) - C_n(n) - P_n(n)\sigma[S_m + J(\pi)]. \qquad (25)$$

Together, these conditions reflect the *incentive-compatibility constraint*, defining the agent's effort choice to be $\langle \hat{m}, \hat{n} \rangle$.[250] Conditions (24) and (25) show that the manager's rational choice of both forms of effort is increasing in his revenue share, and his choice of antisocial effort *n* is increasing in his private gain from crime.[251]

Since the firm cannot observe the manager's effort, the employment contract receives its structure by satisfying the *individual-rationality constraint*, $U(\hat{m}, \hat{n}) \geq k$, and the *incentive-compatibility constraint*, $\langle \hat{m}, \hat{n} \rangle$. Applying these constraints

248. *See* Becker, *supra* note 58, at 193.

249. More generally, intrafirm information asymmetries are intrinsic to companies' hierarchical structures of management, monitoring, and control. *See* Jensen & Meckling, *supra* note 66.

250. This *incentive-compatibility constraint* dictates the manager's rational choice of continuous effort levels $\langle \hat{m}, \hat{n} \rangle$ given the incentive structure defined by the law enforcement policy. Since both the first- and second-order conditions for a utility maximum hold, this choice is unique. This presentation of the *incentive-compatibility constraint* is borrowed from Garoupa.

251. Recall that $C_n, C_m, E_n > 0$.

and combining with equation (23), the firm's expected profit becomes a function of induced effort levels:

$$B = (\hat{m} + \hat{n}) + E(\hat{n}) - C(\hat{m}, \hat{n}) - P(\hat{n})\sigma\left(S_f + S_m + J(\pi)\right). \quad (26)$$

As the firm chooses the revenue-sharing parameter μ to maximize profits, take the first-order condition using the chain rule:

$$B_\mu = B_m \hat{m}_\mu + B_n \hat{n}_\mu = 0. \quad (27)$$

Where

$$B_m = 1 - C_m(\hat{m}) \quad (28)$$

$$B_n = 1 + E_{\hat{n}}(\hat{n}) - C_n(\hat{n}) - P_n(\hat{n})\sigma\left[S_a + S_p + J(\pi)\right]. \quad (29)$$

Combining equations (28) and (29) with equations (24) and (25), one obtains

$$B_m = 1 - \mu \quad (30)$$

$$B_n = 1 - \mu - P_n(\hat{n})\sigma S_f. \quad (31)$$

Aligning the firm's incentives with social welfare by setting equation (3) equal to equation (26) recovers equation (4) as the joint condition for a law enforcement policy that fully internalizes the costs of crime.

In the absence of corporate liability ($S_f = 0$), equation (24) shows that the optimal contract is to pay the manager his full marginal product (i.e., $\mu = 1$), thereby incentivizing the maximal choice of productive effort $\hat{m}$. When all criminal sanctions fall on the manager, he assumes the full risk of criminal prosecution and thus requires the full benefit from wrongdoing. Equations (24) and (31) dictate that corporate liability reduces the manager's revenue share and decreases productive effort $\hat{m}$. This intrafirm incentive distortion means that optimal policy requires maximizing fines against the manager before instituting corporate liability. However, the optimal fine will likely exceed the manager's collectable wealth, represented by the *individual-wealth constraint* $S_m \leq \overline{W}$. Since social-welfare maximization accounts for the disutility of this incentive distortion, optimal policy in the presence of moral hazard will not fully internalize the costs of crime.[252]

If the *TBTJ constraint* $S_f \leq \xi$ binds, there will be underdeterrence and inefficiently high negative externalities in the form of elevated corporate crime. To optimally internalize the social harm of crime when both the *individual-wealth* and *TBTJ constraints* bind, authorities must be willing to impose nonmonetary

252. *See* Garoupa, *supra* note 64, at 247.

penalties on the manager. To account for the efficiency costs of intrafirm incentive distortion, represented by $\zeta(\mu)$, adjust equation (6) to find the socially optimal threat of incarceration[253]:

$$\pi = J^{-1}\left[\frac{H+D(\pi)}{\sigma} - \overline{W} - \xi - \zeta(\mu)\right]. \tag{32}$$

3. *Additional Derivations When the Firm Can Cooperate*

The manager's first-order conditions are

$$U_m = \mu - C_m = 0 \tag{33}$$

$$U_n = \mu + E_n(n) - C_n(n) - P_n(n)[\rho + (1-\rho)\sigma][S_m + J(\pi)] = 0. \tag{34}$$

Together equations (33) and (34) define the *incentive-compatibility condition* on the manager's effort choice $\langle\widetilde{m}, \tilde{n}\rangle$. Including the costs of the internal-control mechanism $T(\rho)$ and corporate liability S_R resulting from turning over evidence of employee wrongdoing, the firm's profit function is

$$B = (1-\mu)(\widetilde{m} + \tilde{n}) - \omega - P(\tilde{n})\left[\rho S_R + (1-\rho)\sigma S_f\right] - T(\rho). \tag{35}$$

Combining this with equation (7) and subject to the *individual-rationality constraint* $(U \geq k)$, the firm's profit rearranges to

$$\begin{aligned} B &= (\widetilde{m} + \tilde{n}) + E(\tilde{n}) - C(\widetilde{m}, \tilde{n}) \\ &\quad - P(\tilde{n})\begin{bmatrix} \rho\big(S_R + S_m + J(\pi)\big) + \\ (1-\rho)\sigma\left(S_f + S_m + J(\pi)\right) \end{bmatrix} - T(\rho) - k. \end{aligned} \tag{36}$$

This profit function (36) reflects that the firm funds a compliance department and reports managerial credibility with probability ρ. Use the chain rule to calculate the first-order conditions:

$$B_\mu = B_n\tilde{n}_\mu + B_m\widetilde{m}_\mu = 0 \tag{37}$$

$$B_\rho = B_n\tilde{n}_\rho + B_m\widetilde{m}_\rho - P(\tilde{n})\begin{bmatrix} \big(S_R + S_a + J(\pi)\big) - \\ \sigma\left(S_f + S_m + J(\pi)\right) \end{bmatrix} - T_\rho = 0. \tag{38}$$

Where

$$B_n = 1 + E_n(\tilde{n}) - C_n(\widetilde{m}, \tilde{n}) - P_n(\tilde{n})\begin{bmatrix} \rho\big(S_R + S_a + J(\pi)\big) + \\ (1-\rho)\sigma\left(S_f + S_m + J(\pi)\right) \end{bmatrix} \tag{39}$$

253. Efficiency costs are zero when the manager's revenue share is unity, and they increase as the firm retains more of the proceeds from the manager's output [i.e., $\zeta(\mu = 1) = 0$; $\zeta_\mu(\mu \in [0,1]\,) < 0$].

$$B_m = 1 - C_m = 0. \tag{40}$$

Combining with equations (33) and (34) then rearranging, these conditions become

$$B_n = 1 - \mu - P_n(\tilde{n})\left[\rho S_R + (1-\rho)\sigma S_f\right] \tag{41}$$

$$B_m = 1 - \mu = 0. \tag{42}$$

This defines the firm's optimal contract set $\langle \tilde{\mu}, \tilde{\rho} \rangle$, conditional on law enforcement policy.

As before, align the firm's objective with the social-welfare function:

$$W = (m+n) + E(n) - C(m,n) - P(n)[H + D(\pi)] - T(\rho) - k. \tag{43}$$

Setting equations (43) and (36) equal and accounting for the costs of intrafirm incentive distortion ζ recovers a condition for the optimal sanctions regime

$$H + D(\pi) = \rho S_R + (1-\rho)\sigma S_f + [\rho + (1-\rho)\sigma]\big(S_m + J(\pi)\big) + \zeta(\mu). \tag{44}$$

If the risk-adjusted social harm is large enough that the *individual-wealth constraint* binds and individuals escape liability ($\pi = 0$), then crime will be underdeterred without corporate liability. Imposing optimal corporate liability requires sanctions to satisfy

$$\rho S_R + (1-\rho)\sigma S_f = H - [\rho + (1-\rho)\sigma]\overline{W} - \zeta(\mu). \tag{45}$$

However, if social harm H is sufficiently large or the probabilities of conviction sufficiently small and the case involves a TBTJ firm, the *TBTJ constraint* will bind, such that $S_R = S_f = \xi$. If $\pi = 0$, then the *TBTJ constraint* binds when social harm is large enough that

$$H \geq [\rho + (1-\rho)\sigma](\xi + \overline{W}) - \zeta(\mu). \tag{46}$$

As discussed above, if the *TBTJ constraint* binds, financial crime will be underdeterred unless the manager expects to face incarceration:

$$\pi = J^{-1}\left[\frac{H + D(\pi)}{\rho + (1-\rho)\sigma} - \overline{W} - \xi - \zeta(\mu)\right]. \tag{47}$$

APPENDIX B: DEFERRED PROSECUTION AGREEMENT PROCEDURES ACT

§ 1 – Procedures for Corporate Deferred Prosecution Agreements

(a) The procedures in this section shall apply to any written agreement that is authorized under 18 U.S.C. § 1361(h)(2), that is between the United States and a defendant business organization, and that excludes any period of delay from the time limitations specified in the Speedy Trial Act, 18 U.S.C. § 1361, during which the attorney for the government defers prosecution for the purpose of allowing the defendant to demonstrate its good conduct.

(b) **Definitions –** For the purposes of this section, the following definitions apply:

  (1) "Defendant" refers to an organization, as defined by 18 U.S.C. § 18 as "a person other than an individual" – including corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and nonprofit organizations[254] – that has been charged with any offense in an indictment or criminal information filed in any federal district court;

  (2) "Deferred Prosecution Agreement," "Agreement," or "DPA" refer to any proposed agreement reached between the United States and a Defendant that would exclude any period of delay from the time limitations specified in 18 U.S.C. § 1361, pursuant to 18 U.S.C. § 1361(h)(2);

  (3) "Financial Penalties" refers to any fine, disgorgement of unlawful proceeds, or any other financial payment made by a Defendant to the United States pursuant to a DPA;

  (4) "Structural-Reform Mandate" refers to any provision of an Agreement that requires a Defendant to undertake any action, other than payment of Financial Penalties;

  (5) "Monitor" refers to an attorney charged with overseeing the implementation of any Structural-Reform Mandate and filing reports on the progress of that implementation with the court and with the United States.

(c) The Attorney General shall issue regulations specifying the factors to be considered in entering into DPA negotiations with a Defendant, entering into a DPA, determining the adequacy of any Financial Penalties or Structural-Reform Mandate, and determining whether a Defendant has breached the terms of an applicable Agreement.

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254. *Cf. Guidelines Manual*, U.S. SENT'G COMMISSION § 8A1.1 (Nov. 1, 2015), https://www.ussc.gov/sites/default/files/pdf/guidelines-manual/2015/GLMFull.pdf [https://perma.cc/F4J6-JJFH].

(d) **Form of Agreement—**Any joint motion for the court's approval of the proposed Agreement under 18 U.S.C. § 1361(h)(2) shall include:
   (1) An indictment or criminal information stating the theory of criminal liability;
   (2) A statement of facts;
   (3) A written Agreement, stating its terms in their entirety, including the term of the Agreement during which prosecution will be deferred and any Financial Penalties, Structural-Reform Mandate, restitution made to victims of the Defendant's crime, or protocol to govern a Monitor's supervisory authority and reporting obligations; and
   (4) A statement from the attorney for the government explaining why the Agreement's terms are a sufficient punishment for the Defendant's crime, how the agreement will promote the Defendant's reform or prevent future unlawful conduct, and how the decision to defer prosecution and enter the Agreement serves the public interest.

(e) **Judicial Approval—**Before approving any Agreement or exclusion of time pursuant to 18 U.S.C. § 1361(h)(2), the court shall independently determine:
   (1) that the indictment or information states a sufficient theory of criminal liability and that the statement of facts contains sufficient detail to support the theory of liability; and
   (2) that the approval of the Agreement serves the public interest.

(f) **Procedure for Judicial Approval—**
   (1) In making its determination under subsection (2), the court may:
      (A) take testimony of government officials, witnesses, or experts, upon the motion of any party or participant or upon its own motion, as the court may deem appropriate;
      (B) obtain the views of any individual, group or agency of government with respect to any aspects of the proposed Agreement, in such a manner as the court deems appropriate;
      (C) appoint an independent attorney as amicus curiae to brief the court on any aspect of the proposed Agreement or its effects;
      (D) consider any letters or other submissions from victims, government officials, or any interested party; and
      (E) take such other action in the public interest as the court may deem appropriate.
   (2) Upon motion of the Defendant, or upon its own motion, the court may require the government to offer evidence sufficient to reasonably infer any fact in the statement of facts or any legal conclusion in the indictment or information. The evidence offered by the government need not be admissible under the Federal Rules of Evidence, and the court may, for good cause, permit the evidence to be filed under seal. No Agreement

may include a provision in which a Defendant forfeits its right to make a motion under this subsection.

(g) **Effect of Agreement—**

(1) Proceedings before the district court under subsection (f)(1) and statements prepared by the government under subsection (d)(4) shall not be admissible against any Defendant in any action or proceeding brought by a private party against such Defendant.

(2) A Defendant may interpose the Agreement as a complete defense to any criminal action brought by the federal government arising from the same conduct as that covered in the Agreement.

(h) **Conduct of Monitors—**

(1) If the Agreement includes provisions for the appointment of a Monitor:

(A) The court must approve the monitor's appointment.

(B) The Monitor's reports shall be filed with the court.

(C) The Monitor's reports shall be deemed judicial documents, and redacted or summary versions shall be publicly accessible unless the statement prepared pursuant to subsection (d)(4) provides good cause for permitting the reports to be filed under seal. If any reports or summaries are to be publicly disclosed, the court shall permit the parties to propose redactions of confidential business information or summaries.

(D) At any time while the Agreement is in effect, the parties may petition the court to object to the Monitor's conduct, and the court may direct the Monitor to act as it deems appropriate.

(2) The Attorney General shall issue regulations governing the selection, supervision, and conduct of Monitors.

(i) **Administration—**

(1) The Attorney General shall establish an Office of Corporate Reform ("the Office") in the Department of Justice.

(2) Attorneys for the government negotiating an Agreement with a Defendant shall coordinate with the Office regarding the specification of any Structural-Reform Mandates or Monitor protocols.

(3) The Office shall be responsible for overseeing pending DPAs to verify that Defendants comply with their terms.

(4) In discharging its responsibilities under this subsection, the Office shall work cooperatively with any appropriate state, federal, or private regulators.

(j) **Terminating the Agreement—**

(1) At the end of the Agreement's specified term, the court shall dismiss the pending charges unless the United States provides good cause to find that the Defendant has violated its obligations under the Agreement, in

which case the court may maintain the pending charges on its docket and extend the Agreement for a period up to one year.

(2) At any time while the Agreement is in effect and on a motion for good cause, the court may permit the United States to terminate the Agreement and resume prosecution if the court finds that the Defendant has materially breached the Agreement. The Defendant may oppose termination and call witnesses in its defense.

(k) **Transparency**—

(1) The Attorney General shall, subject to the exceptions permitted by subsection (k)(3), make publicly available all Agreements that have been approved under paragraph (e) of this section or submitted for such approval. These Agreements shall be posted in a searchable format and on a prominent place on the Department of Justice's website. For each posted Agreement, the listing shall include:

(A) all documents listed in paragraph (d) of this section that were filed with the court when approval was sought;

(B) the date on which the parties entered into the settlement;

(C) the date on which the settlement shall terminate subject to subsection (j)(1);

(D) the names of the Defendants that settled claims under the Agreement;

(E) the names of any natural persons prosecuted in connection with the conduct covered under the Agreement and the outcomes of those prosecutions;

(F) the identity of any appointed Monitor;

(G) any public statement required under subsection (3); and

(H) for each Defendant—

1. the total Financial Penalties to be paid under the Agreement;
2. the amount, if any, that is expressly designated as criminal or civil penalties or fines;
3. the amount, if any, to be paid in restitution to victims of the Defendant's crime;
4. the amount, if any, expressly specified under the Agreement as not tax-deductible;
5. any actions the Defendant is taking in lieu of a payment to a federal, state, or local government entity;
6. any actions the Defendant has already taken that are credited in the Agreement as being in lieu of a payment to a federal, state, or local government entity.

(2) The Attorney General shall maintain the public accessibility of material required to be posted under subsection (1) for no fewer than five years

after the date on which the settlement shall terminate subject to subsection (j)(1).

(3) The requirement to disclose any piece of information listed under subsection (1) shall not apply if the Attorney General determines that maintaining the confidentiality of that information is necessary to protect the public interest of the United States. If any information is kept confidential under this authority, the Attorney General shall issue a public statement explaining why such action is necessary to protect the public interest of the United States. This statement shall explain:
   (A) what interests confidentiality protects; and
   (B) why the interests protected by confidentiality outweigh the public's interest in knowing about the conduct of the federal government and the expenditure of federal resources.

§ 2—Prohibition of Nonprosecution Agreements

(a) It shall be unlawful for the government to enter into any agreement with a business organization in which the government agrees to decline prosecution in exchange for payment of a fine, penalty, or other monetary consideration. Nothing in this section shall be construed as preventing the government from issuing advisory opinions, issuing no-action letters, entering into immunity agreements, entering into civil consent decrees filed in a court, or entering plea bargaining agreements governed by Federal Rule of Criminal Procedure 11.

(b) The government may enter an agreement with a business organization to defer prosecution in exchange for consideration, pursuant to its authority under 18 U.S.C. § 1361(h)(2) and subject to the requirements of § 1 of this Act, provided any such agreement is approved by a district court with jurisdiction.

(c) Any agreement that violates this section shall be void and unenforceable as a matter of public policy.