

Uriel Procaccia\* & Eyal Winter\*\*

## Corporate Crime and Plea Bargains\*\*\*

### Abstract

Corporate entities enjoy legal subjectivity in a variety of forms, but they are not human beings. Hence, their legal capacity to bear rights and obligations of their own is not universal. This Article lays out a stylized model that explores, from a normative point of view, one of the limits that ought to be set on corporate capacity to act "as if" they had a human nature – the capacity to commit crime. Accepted wisdom states that corporate criminal liability is justified as a measure to deter criminal behavior. Our analysis supports this intuition in one subset of cases, but also reveals that deterrence might in fact be undermined in another subset of cases, especially in an environment saturated with plea bargains involving serious violations of the law.

### The Framework

The separate legal person of corporate entities is a prevalent staple of developed legal systems and is commonly interpreted as a device to allocate risk among corporate constituencies, and especially between owners and creditors.<sup>1</sup> It is equally clear, however, that corporations are distinct from natural persons and hence their legal subjectivity, i.e. their capacity to bear rights and obligations of their own, is limited. For example, corporations cannot be elected to public office. These limits are a perennial subject of discussion which permeates numerous fields of

---

\* Wachtell, Lipton, Rosen and Katz Professor Emeritus of Corporate Law and member, the Federmann Center for the Study of Rationality, The Hebrew University; research professor the Cegla Institute, the Buchmann Faculty of Law, Tel Aviv University.

\*\* Silverzweig Professor of Economics and member, the Federmann Center for the Study of Rationality, the Hebrew University.

\*\*\* Thanks are due to Ronen Avraham, Sharon Hannes, Alon Harel, Omer Kimhi, Ariel Porat, and the editorial board of this journal for helpful comments on former drafts. Yonatan Horan and Ori Marom provided excellent research assistance.

<sup>1</sup> This assertion is based on the premise that as long as a corporation is solvent the "veil" separating the corporation from its owners is allowed to remain intact – i.e., need not be "pierced." and hence there is less meaning to the separateness of corporate rights and obligations. Once the corporation becomes insolvent, however, the veil protects owners from the reach of the corporate creditors; hence the existence of a veil is a mode of allocating the risk of insolvency to the creditors – rather than to the owners of the firm. The efficiency reasons behind opting for such an allocation of risk, especially in the case of publicly held firms, is articulated, *inter alia*, in Frank Easterbrook and Daniel Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985).

law.<sup>2</sup> This Article explores one of these borderline cases – the issue of corporate crime.

It was famously stated that corporations do not have a "body to be kicked" or a "soul to be saved."<sup>3</sup> If this is true, can a soulless, bodiless entity commit a crime? As a matter of positive law, jurisdictions vary on this question. Whereas in common law systems corporations are frequent defendants in criminal proceedings,<sup>4</sup> in some important civil law jurisdictions (Germany for example) the accepted wisdom is that companies are "incapable" of forming criminal intent (*mens rea*) and thus are immune to criminal charges.<sup>5,6</sup> Although this purist view has waned in a number of European jurisdictions in recent years, for convenience we refer to it as the "European approach," in contrast to the traditional common law approach that recognizes corporate criminal liability.

In what sense does the European approach doubt the capacity of corporations to engage in criminal behavior? Clearly, corporations are no less "capable" of forming *mens rea* than they are competent to form contractual resolve or delictual intent, and yet they are universally recognized as bearers of contractual or delictual rights and obligations. In fact, companies cannot *do* things to a greater extent than they can *intend* to do them; hence, even corporate *actus reus*, which is routinely worked into European criminal jurisprudence, let alone contractual or tortious liability, raises exactly the same conceptual "capacity" difficulties as the psychological intention to commit a felony. Since as a matter of empirical

---

<sup>2</sup> Discussions about the nature and scope of the so-called "artificial" legal person have a long and respectable pedigree. For a general survey, see Martin Wolff, *The Nature of Legal Persons*, 54 LAW Q. REV. 494 (1938).

<sup>3</sup> To the best of our knowledge, Lord Edward Thurlow, who served for a number of years as Lord Chancellor of England in the 18<sup>th</sup> Century, was the first to use a similar metaphor.

<sup>4</sup> In actuality, crimes are committed by natural persons. Since traditional English law was loath to ascribe to anyone, including a corporation, vicarious criminal liability for a crime committed by someone else, it developed the so-called "organic theory" which holds that certain key officers are not mere agents of the corporate entity, but are actually its "organs." Consequently, the corporation's liability for their crimes is "direct", or "personal," rather than vicarious. For a line of case embracing this view and their analysis, see L.C.B. GOWER, *PRINCIPLES OF MODERN COMPANY LAW* 206 et seq. (4<sup>th</sup> ed., 1979).

<sup>5</sup> An excellent comprehensive summary of the current state of corporate criminal liability in a variety of important European jurisdictions was prepared by the Clifford Chance Law Firm, *available at* [http://www.cliffordchance.com/content/dam/cliffordchance/PDFs/Corporate\\_Liability\\_in\\_Europe.pdf](http://www.cliffordchance.com/content/dam/cliffordchance/PDFs/Corporate_Liability_in_Europe.pdf) (2012).

<sup>6</sup> The notion that corporate entities are not capable of committing crime is probably fed by the narrative one imagines when imagining criminals, a narrative which does not sit well with non-human offenders. On the psychology of thinking about criminals in this context, see Tom Tyler and Avital Mentovich, *Punishing Collective Entities*, 19 J. L. & POL'Y 203 (2015).

observation corporations cannot either *do* or *intend* to do anything, the question must be removed from the realm of *is* and placed in the realm of *ought*; namely should corporations, as a normative matter, be treated *as if* they could form criminal intent and be charged with crimes – in spite of the fact that they are obviously nothing but a figment of the human imagination.

Clearly, corporate criminal liability entails some externalities that mutilate against the concept. The corporate entity does not mind the severity of the sanction, simply because it does not possess the potential to suffer. Rather, those who suffer are often innocent agents, like stockholders and other stakeholders whose personal fortunes are tapped to foot the bill. But externalities of this nature are perennial both in the non-corporate world and in corporate law. Outside of corporate law, if a defendant is found guilty and sanctioned, a multitude of innocents, such as family members, creditors or business associates could be unintentionally, but unavoidably, penalized. Within corporate law, stakeholders pay the consequences of corporate contract breaches, tort malfeasance, or other violations of the law at the same level as when a company pays a criminal fine. The added element of criminal sanctions, the stigma resulting from conviction, does not normally attach to innocent corporate agents, because stigma is a moral response to turpitude, and innocent stakeholders are often clean as a whistle. In an imperfect world, these necessary externalities are treated as collateral damage and dismissed with a nod.

Even if we put aside negative spillovers affecting innocent agents, we still have to answer the normative question: Why impose criminal responsibility on the corporate form? Accepted wisdom is straightforward in this respect: it is speculated that corporate criminal liability enhances the goal of deterrence.<sup>7</sup> The argument goes like this: Corporate incumbents, such as corporate directors and officers, personally loath their corporation being convicted in criminal proceedings. Some are

---

<sup>7</sup> Obviously, deterrence is not criminal law's only objective. For instance, the philosophy of retribution or an interest in preventing perpetrators from committing future violations may motivate criminal law. But such objectives are hardly applicable to corporate crime, which seems to be mainly motivated by the goal of deterrence. For various aspects of this hypothesis see, e.g., Henry Edgerton, *Corporate Criminal Responsibility*, 36 YALE L. J. 827, 833 (1927); Bruce Coleman, *Is Corporate Criminal Liability Really Necessary?*, 29 SW L. J. 908, 919 et seq. (1975); CELIA WELLS, CORPORATIONS AND CRIMINAL RESPONSIBILITY 31 (1993).

motivated by pure respect for the law; others, even those who are not themselves without unblemished behavior, recognize that their personal fortunes depend, to greater or lesser extent, on corporate appearance of lawfulness and trustworthiness. A director or officer whose firm was publicly exposed for criminal activity under her watch may be severely disciplined by the forces of the market for managerial talent<sup>8</sup>, and arguably, to a lesser extent, by those of the capital market<sup>9</sup> and the market for corporate control<sup>10</sup>. To avoid being in that spot, directors and officers (except the perpetrator of the crime himself) have a strong incentive to monitor each other's potentially criminal behavior and to otherwise guard not only against corruption *per se*, but rather against the resulting personal embarrassment. With an army of spies, crime gets to become more costly, and at an equilibrium, more scarce<sup>11</sup>.

To make the story even more convincing, a plethora of laws have been passed in many jurisdictions, that impute corporate criminal responsibility on senior directors and officers as well, unless they can exculpate themselves by proving that the crime was committed without their knowledge and that they were not negligent in preventing its occurrence.<sup>12</sup> In Israel, this practice is particularly prevalent, as special statutes impute corporate crimes on directors and officers in a large gamut of "relevant" crimes, i.e. those that are typically committed by entities. The total number of such statutes in Israel is about 150. They

---

<sup>8</sup>This is either because she could be sued by the corporation for breach of a fiduciary obligation, or because the demand for her services is anticipated to decline.

<sup>9</sup> Firms with a criminal record might find it costlier to raise funds and hence to compete against other firms with a lower cost of capital.

<sup>10</sup> Severe criminal sanctions could depress the value of a corporation's stock and make it easy prey for hostile takeover bids, in which incumbent officers would lose their grip on their position of stewardship.

<sup>11</sup> See Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEG. STUD. 833 (1994). In this thoughtful piece, Professor Arlen both documents this common contention and criticizes it.

<sup>12</sup> See, e.g., the Statute Law Amendment (Directors' Liability) Act 2015 (NO 26 OF 2015) (Austl.), which was passed in Victoria, Australia which amended a variety of laws to include a clause that imputes corporate criminal liability to corporate officers, unless they can prove their diligence in preventing the crime. In the United States, an evolving doctrine imputes personal liability on senior officers under certain statutes, such as the FDA Food Safety Modernization Act, P.L. 111-353; Resource Conservation and Recovery Act, 42 U.S.C.; Clean Air Act, 2 U.S.C. ; and the Water Pollution Control Act, 33 U.S.C. See Brenda Hustis & John Gotanda, *The Responsible Corporate Officer: Designated Felon or Legal Fiction?*, 25 LOY. U. CHI. L. J. 169 (1994); Cynthia Finn, *The Responsible Corporate Officer, Criminal Liability and Mens Rea: Limitations on the RCO Doctrine*, 46 AM. U. L. REV. 543 (1996).

regulate a wide variety of issues: tax evasions of all kinds,<sup>13</sup> antitrust violations,<sup>14</sup> health and environmental infractions,<sup>15</sup> labor and employment law violations<sup>16</sup> and a rich repertoire of additional crimes that are likely to be committed by corporations.<sup>17</sup> Imputing corporate liability to human actors also influences the secondary legislation domain, i.e., government regulations<sup>18</sup> and municipal ordinances.<sup>19</sup> This practice in itself has some unsavory aspects because it imposes vicarious criminal liability on these senior officers, for crimes of *mens rea*, in spite of the fact that their state of mind was mere negligence; the silver lining is that the fear of personal criminal liability augments the innocent agents' incentive to monitor potential perpetrators to further reduce the incidence of crime. Let us assume *arguendo* that if that were the end of the story we would have been content to interpret this "massacre of the innocents" as if it were just another necessary form of collateral damage.

Unfortunately, there is another angle to this story, which has to do with the political economy of prosecutors and courts, and the game they play with corporate incumbents. Prosecutors are commonly rewarded, through

---

<sup>13</sup> See, e.g., Income Tax Ordinance, 5721-1961, § 224A, as amended (Isr.); Value Added Tax Law, 5736-1975, § 119 (Isr.); Real Estate Tax Law, 5723-1963, § 99 (Isr.); Property and Compensation Fund Tax Law, 5721-1961, § 58 (Isr.); Section 224A of the Income Tax Ordinance; Section 119 of the Value Added Tax Law, 1975; Section 99 of the Real Estate Tax Law, 2011; Section 58 of the Property and Compensation Fund Tax Law, 1961 and the Profits from Natural Resources Tax Law, 5771-2011, § 28 (Isr.). Section 28 of the Profits from Natural Resources Tax Law, 2011.

<sup>14</sup> Limitation of Trade Law, 5748-1988, § 48 (Isr.). Section 48 of the Limitation of Trade Law, 1998.

<sup>15</sup> In this endless list some prominent examples are Section 72 of the Clean Air Law, 2011; Section 18(b) of the Prevention of Oil Pollution of the Sea Ordinance, 1980; Section 11C of the Prevention of Environmental Hazards Law, 1961; Section 16 of the Removal and Recycling of Tires Law, 2007; Section 6A of the Prevention of Sea Pollution from Land Sources Law, 1988; Section 15 of the Maintenance of Hygiene Law, 1984; Section 71D of the National Health Ordinance, 1940; Section 257 of the Protection of Public Health (Food) Law, 2015 and Section 31 of the Regulation of Pest-Control Professionals Law, 2016.

<sup>16</sup> For example, Section 38 (b) of the Youth Employment Law, 1953; Section 16 of the Equal Opportunity in the Workplace Law, 1988; Section 220 of the Maritime (Sailors) Law, 1973; Section 22 of the Income Guarantee Law, 1980; Section 19 (48) (5) of the Equal Opportunity for People with Disability Law, 1998; Section 29 of the Annual Vacation Law, 1951; Section 32(b) of the More Effective Enforcement of the Laws of Employment Law, 2011 and Section 15(b) of the Women's Employment Law, 1954.

<sup>17</sup> This varied list includes, for example, Section 126A(b) of the Mutual Funds Law, 1994; Section 53 (e) of the Securities Law, 1968; Section 111A (b) of the Mines Ordinance; Section 16 of the Holocaust Victims Claims Law, 1957; Section 143 of the Aviation Law, 2011; Section 30 of the Struggle Against the Iranian Nuclear Project Law, 2012; Section 63 of the Copyright Law, 2007; Section 55 of the Electricity Law, 1996 and Section 46 of the Regulated Housing Law, 2012.

<sup>18</sup> See, e.g., Protection of Animals (Raising of Pigs) Regulation, 5775-2015, §30 (Isr.) Regulation 30 of the Protection of Animals (Raising of Pigs) Regulation, 2016 or Ports (Loading Regulation 63 of the Ports (Loading and Unloading of Oils) Regulation, 1975.

<sup>19</sup> For example, the Section 33 of the Jerusalem Municipality (Public Signs) By-Laws or Section 101 (b) of the Kfar-Sava Municipality (Maintenance of the Environment) By-Laws, 2008.

promotion and otherwise, on the basis of their "success rate" in prosecutorial activities. Since it is hard to gauge what "success" precisely means, there is a prevalent practice to interpret the concept as a forensic effort resulting in conviction.<sup>20</sup> Indeed, Israel's staggering conviction rate, about 99.5% of all criminal trials, is at least partially explained by the fact that even if there is a single conviction in a multi-party, multi-defendants criminal trial, the result is counted as a "conviction." Less attention is focused in reaching that rate of conviction on the number of convicted suspects in any given charge or on the severity of the sentence.<sup>21</sup>

It is well-known that most criminal proceedings involve plea bargaining<sup>22</sup> which judges are normally happy to embrace, since the alternative is a lengthy and cumbersome trial that is a burden on their congested dockets as well as on their leisure activities. Now it works to the advantage of everyone (except corporations and their innocent stakeholders) to strike a deal, in which directors and officers plead guilty on behalf of the corporation, in exchange for dropping the personal charges against them. The officers get an easy way out of a looming conviction; the prosecutors

---

<sup>20</sup> Roger Koppl & Meghan Sacks, *The Criminal Justice System Creates Incentives for False Convictions*, 32 CRIM. JUST. ETHICS 126 (2013) (discussing prosecutors incentives to ensure convictions in criminal trials, in spite of their presumed role as officers of the court whose only objective function should be minimizing judicial error). The authors are careful to observe that these incentives do not necessarily reach a cognitive conscious level, but this possibility does not reduce their prevalence. See also a speech delivered by former US Supreme Court Justice John Paul Stevens at the Equal Justice Initiative held in his honor in New York on May 2, 2011, where he reached similar conclusions, available at [https://www.supremecourt.gov/publicinfo/speeches/Equal%20Justice%20Init%20Dinner%20\(1606\\_00\\_1\).pdf](https://www.supremecourt.gov/publicinfo/speeches/Equal%20Justice%20Init%20Dinner%20(1606_00_1).pdf); see also John Coffee, *An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 836 (1981); Nuno Garoupa, *The Economics of Prosecutors*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CRIMINAL LAW 231 (Alon Harel & Keith Hylton eds., 2012); Stephanos Bibas, *Plea Bargains Outside the Shadow of Trial*, 117 HARV. L. REV. 2463 (2004); Albert Alschuler, *The Prosecutor's Role in Plea Bargaining*, 36 U. CHI. L. REV. 50 (1968); Stephen Schulhofer, *Plea Bargaining as Disaster*, 101 YALE L. J. 1979 (1992). Another explanation for prosecutorial enthusiasm to plea-bargain has to do with consideration of budget constraints. Litigation is costly, and litigation in the area of white collar crime is particularly so, given the vast resources that are usually marshalled on the defense side. Plea bargains are cheap and generate more convictions, given budgetary constraints, than any type of adversary proceedings. See Jed Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. BOOKS, Jan. 9, 2014, available at <http://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/>. See also Reinier Kraakman, *Corporate Liability Strategies and the Cost of Legal Control*, 93 YALE L. J. 857 (1984). Some commentators emphasize that the average length of prison sentences, rather than the rate of convictions, is what motivates prosecutors as a means of advancing their careers. See Richard Boylan, *What do Prosecutors Maximize? Evidence from the Careers of U.S. Attorneys*, 7 AM. L. & ECON. REV. 379 (2005).

<sup>21</sup> See Oren Gazal-Ayal, Inbal Galon, & Keren Weinshall-Margel, *Conviction and Acquittal Rates in Israel*, Israel Courts Research Division, <http://elyon1.court.gov.il/heb/Research%20Division/doc/Research1.pdf> [in Hebrew].

<sup>22</sup> *Id.*

are relieved from trying a staggering number of criminal cases, and by the same token, improve their conviction rates; and the judges can manage their dockets more easily and spend more time with their grandkids. Only the corporation, since it does not possess a mind of its own to reject the plea bargain, is convicted of crimes that it may have not committed – to the detriment of its stockholders and other innocent stakeholders.

Obviously, and in spite of this incentive-structure, some cases involving corporate crime do go to trial, i.e. do not end in plea bargains. Similarly, some prosecutors decline to be swayed by the personal lure embedded in plea bargains. Our purpose is not to argue that *all* cases are settled out of court, but based on some empirical evidence it is clear that when they do, incumbent officers are normally dropped from the indictment.<sup>23</sup> This is hardly surprising, because it only clarifies that in this context, like in many other contexts, incentives matter. In the following lines, we compare the impact of corporate criminal liability, with and without plea bargains, on incentives to monitor corporate criminality and to deter crime.

### **Discussion**

We formalize, in a rather stylized manner, three possible regimes: no corporate criminal liability ("the European approach"), corporate criminal liability without plea bargains, and corporate criminal liability in which plea bargains abound. This Article concludes that the second case, corporate criminal liability without plea bargains has, at least in the case of serious crimes, the greatest effect on deterrence and consequently on the reduction of crime. Since the main purpose of corporate criminal liability is assumed to be deterrence, and deterrence is particularly important in the case of serious crimes, the normative conclusion of this Article is that plea bargains ought to be banned, or at least closely regulated, in cases of severe violations of the law. The comparison between the two remaining cases, the European approach and corporate criminal liability *cum* plea bargains, is more nuanced. The European approach is clearly the least effective in terms of crime prevention. Its

---

<sup>23</sup> A recent study conducted under the guidance of Professor Oren Gazal-Ayal, Haifa University, analyzed 185 criminal violations and trials (2001-2009) for water pollution. In 95.7% of the cases brought against corporations, senior executives were added as co-defendants. However, in the vast majority of cases in which a plea bargain was struck, 95% of the human actors were dropped from the indictment. Four percent of these cases ended in acquittal.

proponents claim that it has the deontological advantage of inflicting fewer negative externalities on innocent parties, but this claim too seems suspect when viewed from an *ex ante* perspective, because more crime necessarily entails more innocent crime victims.

We model a corporation with a number of senior officers, all of whom, like the other players in our narrative, are assumed to be risk neutral expected-utility maximizers. One of these officers, whose identity is unknown, is a potential offender. If the crime is detected and sanctioned, the same sanction extends to the corporation.<sup>24</sup> In addition, we assume that it also extends to all of its innocent senior officers, unless they can exculpate themselves by proving diligent behavior.<sup>25</sup> One method of exculpation is to report the crime as soon as it comes to their attention and before it is independently detected by law enforcement authorities. The criminal sanction imposed upon conviction is  $C$ . The probability of detection is  $p$ . If the crime is not detected, the perpetrator derives a benefit of  $\beta$ , which is also the cost for society resulting from the commission of the crime<sup>26</sup>. If the crime is detected, every officer, except those who diligently reported the crime to law enforcement authorities, suffers a disutility of  $\alpha$  ( $\alpha < \beta < C$ )<sup>27</sup> occasioned by loss of reputation and resulting market discipline. This loss of reputation is spared to reporting officers because they prevented the commission of the crime; their

---

<sup>24</sup> This is, in essence, the meaning of the English law term "organic theory" of the corporation – i.e., consequences of a crime committed by an "organ" of the corporation affect the corporate entity and not only the perpetrator (*see supra* note 7). In practice, some statutes ordain that the sanction imposed on the corporation be greater than the sanction imposed on the perpetrator. For example, Section 53 of the Israeli Securities Law states that certain fines imposed on corporate entities are five times more severe than those imposed on individual perpetrators. For the purposes of this Article we need not consider this possibility (*see Israeli Securities Law*, ).

<sup>25</sup> One could demur that a more equitable result should scale down the sentence meted out to directors and officers, in accordance with their actual culpability. We have no evidence that this is actually the case. Some statutes imputing corporate criminal liability on its senior officers explicitly state that sanctions against both defendants, corporations, and individuals ought to be the same. (In Israel, *see*, e.g., Section 22 of the Income Guarantee Law, 1980.) It is difficult to substantiate empirically whether the sanctions are identical; particularly given the prevalent practice of letting officers off the hook in exchange for their agreement that the corporation plead guilty. In this Article we assume identical sentences in the rare case a plea bargain was not struck.

<sup>26</sup> For example, if the crime involves embezzlement, the offender's payoff equals the loss of the crime victims.

<sup>27</sup> This expression means that the loss of reputation is less severe than the cost of the crime, and the latter is lesser than the punishment meted out in cases the crime was detected. One could reasonably argue that  $C$  is not uniform across the board. Clearly, some methods of punishment, such as incarceration, cannot be administered for corporate convictions. Likewise, it is possible that in spite of our comment in *supra* note 28 the punishment meted out to the perpetrator might be more severe than that of the innocent officers, because the perpetrator's guilt is direct, and the innocent officers' liability is vicarious. However, in the following analysis these distinctions are irrelevant, because if we stick to the assumption that  $\alpha < \beta < C$  for all players, the results of the following analysis remain intact.



conduct proved their diligence and commitment to lawful corporate behavior. The payoff to the innocent officers in the case of non-detection is zero. We further assume that in a world without plea bargains a detected crime goes to trial and a clairvoyant court convicts the offender. Thus, risk neutral perpetrators are expected to commit the crime if-

$$(1)\beta > p(C + \alpha)^{28}.$$

If  $C$  is set at the socially optimal level, i.e.  $\beta/p$ ,<sup>29</sup> no crime should be committed by rational agents, because its expected benefit to the perpetrator is negative.<sup>30</sup> In that ideal case, corporate criminal liability would be redundant, because there would be no crimes to be deterred. But crimes are committed nevertheless; thus. It must be conjectured that their commission is still prevalent because offenders are over-optimistic and they irrationally under-estimate the magnitude of  $C$  or  $p$ , or over-estimate  $\beta$ .<sup>31</sup> The manner to combat this situation is to devise ways to correct the myopic estimation of the offenders, such that  $C$ ,  $p$  and  $\beta$  attain, in their eyes, realistic proportions. This role is assigned, in the current system, to the innocent officers. Assume that if an innocent officer is charged with the crime committed by the perpetrator, the probability of exculpation based on exemplary behavior is  $q$ . Hence, if a crime is committed by the perpetrator, innocent officers face an expected cost of  $Cp(1-q) + \alpha p$ .<sup>32</sup> Note that if the crime is detected and sanctioned  $\alpha$  is suffered by the innocent officers even if they took diligent efforts to forestall it. Each innocent officer can engage in monitoring efforts at the cost of  $K$ , and she is incentivized to do so if  $K$  is small enough, compared to the risk that a perpetrator would commit a crime and inflict the resulting damage on her peers. The rhetoric is that these monitoring efforts scare away offenders

---

<sup>28</sup> This inequality follows from our assumption that perpetrators are risk neutral expected utility maximizers: They will commit a crime only if the benefit exceeds the penalty plus the cost of loss of reputation times its probability that the crime be detected and penalized. For example, if the penalty is 10 and the loss of reputation is 6 and the probability of detection and punishment is 50%, the crime is assumed to be in the wings if its benefit to the perpetrator exceeds 8.

<sup>29</sup> This is the optimal fine, because it re-internalizes to offenders all the external costs of their crimes, not only those that have been detected and then vindicated.

<sup>30</sup> It is negative because in cases of detection the perpetrator pays not only  $C$ , which fully internalizes the external costs of the crime, but also suffers a disutility of  $\alpha$ .

<sup>31</sup> This observation is not unique to corporate crime. It holds true across the board of human criminality; if the expected cost of punishment exceeds its benefit to the perpetrator, rational actors should be sufficiently deterred from engaging in criminal activity. If crime is nevertheless rampant, the only explanation is that criminals err in their estimation of costs and benefits.

<sup>32</sup>  $C$  is imposed on the innocent officers only by the combined probabilities of detection ( $p$ ) and of non-exculpation ( $1-q$ ). In addition, in cases of detection innocent officers suffer the loss of reputation  $\alpha$ .

and hence actually reduce crime. This is, roughly speaking, the rationale of imposing criminal liability on corporate entities and on their senior officers.

Thus far, we assumed that the perpetrator actually committed the crime, and hence, due to the court's assumed clairvoyance, if the crime is detected (at the probability of  $p$ ) conviction is certain. In other words, the probabilities of detection and that of conviction are identical. But in a world with plea bargains, this assumption may not necessarily hold, because the prosecution may err in its decision to indict and hence the probability of conviction by a clairvoyant court, hereby denoted  $\gamma$ , is less than unity. Of course, if a plea bargain is actually struck, conviction follows as a matter of certainty. If the accused declines to accept the offer, she still retains a chance of  $(1-\gamma)$  to be acquitted. Since all cases are assumed to be concluded with plea bargains, the only defendants, corporate entities, are sometimes penalized without guilt, and when all these cases are aggregated (call their number  $n$ ) corporations (and their innocent constituencies) suffer an unwarranted penalty of  $nC(1-\gamma)$ .<sup>33</sup> Innocent constituencies foot the bill even if the crime had in fact been committed; this "collateral damage" is exacerbated in the case of actual innocence. Let us now examine if this collateral damage is justified in terms of deterrence.

The suspected perpetrator is motivated to accept the bargain in the pre-conviction stage, if-

$$(2) \alpha < C\gamma + \alpha\gamma, \text{ or } \alpha(1-\gamma) < C\gamma^{34}.$$

Since  $C > \alpha$  and if we assume the reasonable assumption that  $\gamma > 0.5$ , the conclusion seems certain that the suspected perpetrator will accept the bargain – whether she is in fact guilty or not.

We now turn our attention to the innocent officers. Risk neutral innocent officers will be incentivized to accept the bargain if-

$$(3) \alpha < C\gamma(1-q) + \alpha\gamma, \text{ or } \alpha(1-\gamma) < C\gamma(1-q)^{35}.$$

---

<sup>33</sup> This is the unwarranted cost of the system because  $n$  corporations pay the penalty of  $C$  in spite of the probability  $(1-\gamma)$  of their innocence.

<sup>34</sup> If the suspected perpetrator accepts the bargain her only penalty is the loss of reputation,  $\alpha$ . She will accept the bargain if  $\alpha$  is smaller than the expected cost of facing trial, which is the criminal penalty  $C$  plus the loss of reputation  $\alpha$ , discounted by the probability of innocence  $(1-q)$ .

Unlike the perpetrator, the set of cases in which the innocent officers might decline to accept the offer is conceivably non-empty; for instance, if  $q = 1$  the inequality will not hold and the bargain will not be struck. Nonetheless it is very reasonable to assume that given the smallness of the left-hand side of the inequality and the empirical evidence that  $\gamma$  is quite substantial (the prosecution wins the vast majority of litigated cases), a bargain will be struck save, again, in those exceptional cases where the innocent officers are quite certain that they can establish their innocence in open court. This conclusion is further buttressed if the innocent officers are risk averse and if the cost of establishing innocence in open court is non-trivial. Finally, we trust that the remaining two players, the prosecutor and the sitting judge, are set to support the bargain as a dominant strategy from their respective points of view.

It now becomes common knowledge that with the exception of the remote possibility that innocent officers will decline to accept a bargain, it will indeed be struck. The question remains how does the realization of this fact affect the *ex-ante* incentives of innocent officers to monitor potential perpetrators.

There are three relevant states of the world. First, a state of affairs mimicking the European approach, where only flesh and blood offenders face criminal liability ("Case 1"). Second, a state of affairs mimicking the common law model, where only corporations may be charged with crimes committed by their senior officers, augmented by some sort of vicarious criminal liability that is imputed to innocent officers unless they can prove some version of good behavior, but exclude plea bargains ("Case 2"). Finally, Case 3 is identical to Case 2 but plea bargains abound.

We start by comparing Case 1 to Case 2. In Case 1, monitoring efforts are expected to occur if  $K < \alpha p$ . In Case 2, on the other hand, more monitoring efforts will be invested, since they are expected to materialize if  $K <$

---

<sup>35</sup> As is with the case of the perpetrator, if the innocent officers accept the plea bargain their only cost is  $\alpha$ . However, if they go to trial their expected cost is smaller than the expected cost of the perpetrator, because they can exculpate themselves at the probability of  $(1-q)$ .

$Cp(1-q) + \alpha p$ ; Clearly, then, Case 2 dominates Case 1 in terms of the objective of reducing crime.<sup>36</sup>

We proceed now to compare Case 2 to Case 3. As we just observed, senior officers will have an incentive to monitor perpetrators in Case 2 if  $K < Cp(1-q) + \alpha p$ ; in Case 3, senior officers are already aware that if a suspicion of a crime should be detected they will be offered a plea bargain, and hence their monitoring efforts will be conditioned on  $K < \alpha\gamma$ . It follows that more monitoring efforts are expected to be undertaken in Case 2 if-

$$(4) \quad Cp(1-q) + \alpha p > \alpha\gamma.$$

Now suppose that the sentencing policy approximates its optimum, namely  $C = \beta/p$ . If this is the case we can substitute  $\beta$  for  $Cp$  in the left-hand side of the inequality, such that the inequality can be restated as-

$$(5) \quad \beta(1-q) + \alpha p > \alpha\gamma.$$

We may safely assume that  $\gamma > p$ , because the rate of convictions is considerably higher than the rate of detection. It follows that although  $\beta > \alpha$ , inequality (5) may be violated in cases of insignificant crimes when  $\beta$  is sufficiently small (say, in cases involving relatively insignificant environmental infractions). But in cases of severe criminality, say in some sophisticated antitrust violations, where  $\beta$  is large enough, Case 3 emerges as inferior to Case 2 in terms of crime reduction. For instance, if  $\beta = 10$ ,  $\alpha = 5$ ,  $p = 0.2$ ,  $\gamma = 0.8$ , and  $q = 0.5$ , more attempts to commit crime will be monitored and prevented in a world without plea bargains. The normative implications of this result are quite significant. Plea bargains are not struck because of their "truth value" (defined as a state of the world where the guilty are punished and the innocent are exonerated). Quite the contrary, plea bargains are never aligned with this ideal state of the world, because the negotiated sentence is too slight if the offenders are guilty and too severe in cases of innocence. Plea bargains are struck because they clear congested dockets and make it possible for the administration of criminal justice to move forward and also because they fit the private objective functions of the relevant players. But the resulting injustice is more striking when the bargain is negotiated in cases of

---

<sup>36</sup> This simple result is true, because the inequality is likelier to be satisfied under the common law approach.

serious felonies than it is in instances of minor infractions of the law. Inequality (5) suggests that the time saving obtained by plea bargains ought to be reserved for the lesser crimes (where  $\beta$  is relatively small), but ought to be discarded, or at least closely regulated, in cases of severe violations of the law. Inequality (5) accomplishes two goals: it formalizes this result in terms of crime prevention, and it conforms to the intuition that the truth value of sentences ought to be particularly important in cases of severe criminality.

It remains to be considered how one compares Cases 1 and 3. In this case it is evident the European approach is the least effective measure to reduce crime, since it is clear that  $\alpha p < \alpha \gamma$ . Nor can this drawback of the European approach be easily justified on the grounds that it liberates innocent parties of the need to pay for someone else's depravity: Once the crime of perpetrators is discovered and penalized, they alone bear the consequences; but since there are bound to be more perpetrators under the European approach because monitoring and deterrence are less effective, in the *ex-ante* situation the consequences of the perpetrators' depravity is visited upon a larger number of innocent victims.

One possible objection that is noted in the literature and needs to be addressed before drawing a conclusion suggests that once innocent senior officers are alerted to the commission of the crime they might have an incentive to stonewall it as a means of fending off their personal disutility resulting from its exposure. Clearly, if they engage in this behavior they forfeit their chances of exculpation, which are only reserved for players displaying exemplary behavior. But in a world where everything ends with plea bargains it could be contended that the risk of detection is reduced, from the senior officers' point of view, even without chances of exculpation, to just  $\alpha$ , and this reduction of risk enhances their *ex ante* motivation to hide their damaging information if they become aware of the commission of the crime. However, this analysis does not hold according to the tenets of the present model. Stonewalling officers still face an expected cost of  $\alpha p$  (recall that in the relevant situation  $q = 0$  and  $\alpha = \gamma$ ), whereas early reporting of the crime exposes them to the expected cost of zero. Even if we relax our assumption that exposing the crime obliterates the loss of reputation in its entirety, it is reasonable to assume that it is sufficiently lower than the expected cost of a plea bargain.

## Conclusion

The European approach, which rejects the notion of corporate criminal liability, is supposed to have some attractive features, because it penalizes only the human perpetrators of crime and hence avoids imposing punishment on innocent third parties, such as the corporate stakeholders or members of the managerial team. But this view, which hails the lack of crime spill-overs, seems to be true only in the *ex-post* stage, after the crime had already been committed. In the *ex-ante* stage, it is also important to provide incentives to reduce crime, because the reduction of crime in itself is the best method to mitigate externalities – the adverse effects suffered by the crime victims.

The common law approach is designed to achieve exactly this purpose, to provide incentives to some relevant players, other than the perpetrators themselves, to monitor each other to minimize the occurrence of corporate criminality. These incentives are effective, as far as the relevant innocent players are involved, not only because they abhor crime *per se*, but also because they suffer loss of reputation if corporate criminality occurs on their watch and become known to all and sundry. Their incentives to monitor each other and to prevent crime is enhanced if corporate criminal liability is extended to their own person save in cases where they can establish lack of negligence in preventing the crime. This additional feature, of extending corporate criminal liability to human actors is prevalent in some jurisdictions, Israel being a prime example.

It follows from the above that the main, perhaps the only rationale of both corporate criminal liability and of extending corporate liability to human actors is grounded on the desire to provide incentives for the reduction of crime. However, as is well-known, most criminal trials are concluded with a plea bargain. Plea bargains are necessary as a means to clear judicial dockets, and are favored by all relevant players because they are well-aligned with their personal interests. A common form of plea bargains features a guilty plea by the corporate entity in exchange for letting its senior officers go scot-free. While this practice may sometimes be defended in cases of slight infractions of the law, this is not the case when serious crimes are committed. In the latter case, this practice distorts the incentives to reduce crime and hence destroys the very rationale of both corporate criminal liability in general and of its

extension to corporate incumbents in particular. The normative conclusion of this Article is that plea bargains ought to be taken with a large grain of salt for severe corporate criminality and be rejected by the sitting judge when appropriate. This is not a slight matter to be expected of judges with over-loaded dockets and a chronic deficit of leisure time, but it does seem a noble and essential measure to satisfy the onerous weight of their distinguished vocation.