

## CORPORATIONS, CRIME AND ACCOUNTABILITY<sup>1</sup>

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### OUTLINE

#### 1. *Two basic questions*

##### 1.1 Allocation of individual and corporate responsibility for corporate crime

Who should be held responsible for corporate crime where, as is often the case, the corporations involved are large or medium sized and where literally hundreds of persons may have been implicated? Put another way, what mix of individual and corporate responsibility should we be aiming for in cases where the offence has not been orchestrated by a few masterminds but is more the outcome of a defective corporate system or a criminogenic corporate culture? Transposing the question into a high-level jurisprudential language, was Ambrose Bierce right when, in the *Devil's Dictionary*, he defined a corporation as an ingenious device for the maximisation of profit and the minimisation of responsibility?

##### 1.2 Suitable mechanisms for achieving accountability for corporate crime

What legal mechanisms are best suited to achieving the mix of individual and corporate accountability desired? Much work has been put into revising principles of corporate responsibility (eg corporate fault concepts which, unlike the *Tesco* directing mind notion, are principled and workable) and expanding the range of available sanctions against corporate offenders (eg corporate probation). Relatively little has been said or done, however, about the legal apparatus required to implement a corporate crime control strategy which focusses on *accountability*.

#### 2. *Two main problems*

##### 2.1 Individual accountability undermined in public enforcement

There is an undermining or erosion of individual accountability at the level of public enforcement measures, with corporations rather than individual

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<sup>1</sup> See further B Fisse and J Braithwaite, *Corporations, Crime and Accountability* (Sydney: Cambridge University Press, 1993), referred to below as *CC&A*.

personnel typically being the prime target of prosecution. Prosecutors are able to take the short-cut of proceeding against corporations rather than against their more elusive personnel. As a result, individual accountability is frequently displaced by corporate liability, which serves as a rough-and-ready catch-all device.

*Typical examples*

- EF Hutton and Co., a brokerage firm, engaged in a widespread fraudulent scheme in which its bank accounts were overdrawn by up to \$US 270 million a day without triggering debits for interest; approximately 400 banks were defrauded of \$US 8 million.<sup>2</sup> Hutton pleaded guilty to 2000 felony counts of mail and wire fraud and, under the plea agreement, agreed to pay a \$US 2.75 million fine and to reimburse the banks. No individuals were prosecuted despite the admission of the Justice Department that two Hutton executives were responsible for the fraud "in a criminal sense."
- Fraud and conspiracy charges against four top McDonnell Douglas executives were dropped in return for a guilty plea by the company to charges of fraud and making false statements.<sup>3</sup> Under the plea agreement, McDonnell Douglas incurred a fine of \$US 55,000 and agreed to pay \$US 1.2 million in civil damages.
- The Zeebrugge ferry disaster stemmed from pervasive sloppiness within the ferry company but did not result in prosecutions of managers implicated in the lack of effective control systems.<sup>4</sup>
- The European Commission imposed fines totalling \$US 304 million on 42 cement companies and associations which had carved up the European market and fixed prices.<sup>5</sup> Enterprise liability is the focus of the EC approach to penalising and deterring anti-competitive conduct.
- In *R v Denbo Pty Ltd*, Supreme Court of Victoria, June 14 1994, a company pleaded guilty to manslaughter on the understanding that, if it did so, the directors would not be prosecuted for manslaughter. One director was convicted on charges under the Occupational Health and Safety Act.

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<sup>2</sup> See US, HR, Committee on the Judiciary, Subcommittee on Crime, *E F Hutton Mail and Wire Fraud Case*, Hearings, Pt 1, 99th Congress, 1st Sess, 1985, Pt 2, 99th Cong, 2nd Sess., 1986, Report, 99th Cong, 2nd Sess, 1986; DS Carpenter and J Feloni, *The Fall of the House of Hutton* (New York: Holt & Company, 1989).

<sup>3</sup> See B Fisse and J Braithwaite, *The Impact of Publicity on Corporate Offenders* (Albany, NY: State University of New York Press, 1983) ch 14.

<sup>4</sup> See further C Wells, *Corporations and Criminal Responsibility* (Oxford: Clarendon, 1993); CC&A, 227-30.

<sup>5</sup> "EU Fines Cement Firms for Collusion", *International Herald Tribune*, 1 Dec 1994, 11.

## 2.2 Individual accountability undermined in sanctions against corporate offenders

Where corporations are sanctioned for offences, in theory they are supposed to react by using their internal disciplinary systems to sheet home individual accountability, but the law now makes little or no attempt to ensure that such a reaction occurs.<sup>6</sup> The impact of enforcement can easily stop with a corporate pay-out of a fine or monetary penalty, not because of any socially justified departure from the traditional value of individual accountability, but rather because that is the cheapest or most self-protective course for a corporate defendant to adopt.

### *Typical examples*

- A classic illustration is the reaction of the Westinghouse Corporation upon being convicted and sentenced for its role in the heavy electrical equipment price-fixing conspiracies of 1959-1961.<sup>7</sup> Westinghouse decided against disciplinary action, partly on the ground of a watered-down version of the defence which failed at Nuremberg: "anybody involved was acting not for personal gain, but in what he thought was the best interests of the company." By contrast, the internal discipline exacted by General Electric was relatively severe. All persons implicated in violations of corporate antitrust policy were disciplined by substantial demotion long before any of them were convicted. Those who were later convicted were asked to resign because "the Board of Directors determined that the damaging and relentless publicity attendant upon their sentencing rendered it both in their interest and the company's that they pursue their careers elsewhere."
- In *Trade Practices Commission v Pye Industries Sales Pty. Ltd.*,<sup>8</sup> a decision of the Australian Federal Court, Pye was found to have committed resale price maintenance in violation of the Trade Practices Act, and the court adjourned the matter for sentence. At the sentencing hearing the court was able to conclude that, at the time of violation, "there was an almost total lack of supervision or interest by the board of directors in the conduct of their management and executives in relation to resale price maintenance." However, the court was uninformed as to the nature of

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<sup>6</sup> A rare exception is the explicit inclusion of internal disciplinary action as a factor to be taken into consideration when applying the US Sentencing Commission's guidelines for sentencing organizational defendants. In my view, too little weight is given to the importance of accountability under those guidelines, which deal with a wide range of factors and fail to focus on accountability as a consideration of prime importance in the social control of corporate crime.

<sup>7</sup> See CC Walton and FW Cleveland, *Corporations on Trial* (Belmont, Ca: Wadsworth, 1964) 103. The other companies involved, with the exception of GE, also refrained from internal disciplinary action; see J Herling, *The Great Price Conspiracy* (Washington, DC: Luce, 1962) 311.

<sup>8</sup> (1978) ATPR 40-089.

the company's disciplinary and other responses to the violation; the company itself had not come forward with relevant evidence, and the evidence that had emerged from the trial related to the issue whether a violation had been committed. The court, after describing the violation as "ruthless", and yet having made no finding as to the adequacy or otherwise of the company's disciplinary reactions, imposed a penalty of \$120,000.

### 3. *Two forlorn strategies for achieving accountability for corporate crime*

#### 3.1 **Individualism**

Individual criminal liability, it is sometimes claimed, can do the job of corporate criminal liability. Individualism proposes radical surgery - amputating the corporate leg of liability - as the cure for the present ills of non-accountability for corporate crime:

- (1) if corporate criminal liability were abolished, prosecutors would be forced to proceed against individual officers and employees; and
- (2) if corporate liability for crime were abolished, and if guilty corporate personnel were held criminally liable, there would be no need to worry about the problem of non-assurance of internal accountability which now arises where corporations are subjected to monetary sanctions.

#### *Major limitations of individualism as a strategy for achieving accountability*

- The doctrine of methodological individualism is unable to account adequately for the corporateness of corporate action and corporate responsibility.<sup>9</sup>
- Individualism depends on heroic assumptions about the deterrent capability of individual criminal liability and on false or unimaginative assumptions about the deterrent capacity of corporate criminal liability. The claim that individual criminal liability is sufficient fails to take account of the difficulties of investigation and enforcement resources which largely explain the development of corporate criminal liability.<sup>10</sup> The claim that it is impossible to punish corporations effectively depends on the false assumption that monetary sanctions are the only means of punishment possible and neglects the emergence of corporate probation and the potential of other non-monetary types of corporate sanction.<sup>11</sup>
- Individualism incorrectly presupposes that retributive theories of punishment relate exclusively to human defendants and that fault is a characteristic of human but not corporate entities. Retributive theories of

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<sup>9</sup> See CC&A 19-31.

<sup>10</sup> See CC&A 36-41.

<sup>11</sup> See CC&A 41-44.

punishment can readily be extended to corporate entities.<sup>12</sup> Corporate fault is well recognised, not only in philosophy but also in everyday approaches to the allocation of blame and responsibility.<sup>13</sup>

- Individualism, contrary to pretence, does not adequately safeguard the interests of individuals. Stricter standards of individual criminal liability and compromises of evidentiary or procedural safeguards would be essential if corporate liability were to be abrogated but such a move departs from the liberal values traditionally manifest in individualism. Where stricter standards need to be imposed, a more obvious approach is to rely on corporate liability and thereby to minimise the need to sacrifice liberal protections for individuals.<sup>14</sup> Another key factor is that individualism has failed to recognise the existence of private systems of justice within corporations and ignores or neglects the risks of injustice which arise in internal disciplinary systems.<sup>15</sup>

### 3.2 Enterprise liability

Enterprise liability is a strategy popular among law and economics theorists, especially in the USA (in the heartland of individualism, extremists protect individuals by passing the buck to enterprises).<sup>16</sup> The central claim is that optimal fines or monetary penalties imposed on the corporate defendant will induce the corporation to take efficient measures of internal control. Those measures may but need not necessarily include internal disciplinary action: people within organisations may be sufficiently deterred by the loss imposed on the organisation, in which event internal disciplinary action would be unnecessary and inefficient.

#### *Major limitations of enterprise liability as a strategy for achieving accountability*

- Enterprise liability is not a substitute for individual liability but an essential concurrent form of liability. To assume otherwise is to contradict the long-standing social value attached to individual accountability. One-eyed pre-occupation with enterprise liability is thus patently “other-worldly” and of little or no use as a strategy for resolving the fundamental problems of accountability for corporate crime which now arise.
- Doctrinaire enterprise liability theorists make one-dimensional and fanciful claims about the deterrent efficacy of financial incentives. In particular, they radically discount the value of *responsibility* as a mechanism of social control,<sup>17</sup> neglect the potential efficiency of using

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<sup>12</sup> See CC&A 44-50.

<sup>13</sup> See CC&A 46-49, 24-31.

<sup>14</sup> See CC&A 51-52.

<sup>15</sup> See CC&A 52-53.

<sup>16</sup> See CC&A ch 3.

<sup>17</sup> See CC&A 78-9.

private systems of justice as an avenue for state-backed enforcement of individual accountability,<sup>18</sup> seem blind to the relative merits of non-monetary sanctions and negotiated compliance,<sup>19</sup> and ignore the practical difficulties which arise in trying to assessing financial penalties that are “optimal”.<sup>20</sup> The impracticality of trying to assess optimal financial or other penalties in part explains why accountability is valued as a method of social control. Accountability is a social process which depends on bringing home to people what they have done and why they should not have done it; from that perspective “optimality” emerges not only as impractical but also as socially erosive and counter-productive.

- Enterprise liability does not adequately safeguard the interests of individuals who need to be protected against injustice where action is taken to control corporate crime.<sup>21</sup> The agency theory of the firm is an artificial and very limited explanatory tool. It does not address the major real issues (eg scapegoating) faced by personnel within corporations in the context of accountability for corporate crime.

#### 4. *An Accountability Model*

##### 4.1 **Desiderata**

Many desiderata need to be taken into account in the design of legal mechanisms suited to achieving accountability for corporate crime.<sup>22</sup> The most fundamental desideratum is this:

A strategy for allocating responsibility for corporate crime should seek to maximise the allocation of responsibility to all who are responsible, be they individuals, subunits of corporations, corporations, parent corporations, industry associations, gatekeepers such as accountants and indeed regulatory agencies themselves.<sup>23</sup>

##### 4.2 **Corporate internal discipline systems and their potential**

It is impossible to achieve the common sense aim of holding responsible all who are responsible by relying on the public criminal law system alone. The power of internal disciplinary systems to deliver individual accountability needs to be harnessed as well.<sup>24</sup> This dimension of accountability for corporate crime is increasingly reflected in the work of enforcement agencies and courts but the concept of juristic personality has impeded its recognition. Under the concept of juristic personality, corporations and human persons

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<sup>18</sup> See *CC&A* 80-1.

<sup>19</sup> See *CC&A* 81-8.

<sup>20</sup> See *CC&A* 88-93.

<sup>21</sup> See *CC&A* 93-8.

<sup>22</sup> See *CC&A* chs 5-6 where 20 desiderata are identified and applied.

<sup>23</sup> See *CC&A* 135.

<sup>24</sup> See *CC&A* ch 5.

are treated under the same umbrella. This is profoundly misleading. Major and even medium-sized corporations are centres of power, resemble mini-governments, have internal disciplinary processes and indeed often have de facto legal systems of their own.

Corporations have the capacity but not the will to deliver clearly defined accountability for law-breaking. Enforcement agencies and courts of law, obversely, may have the will but lack the capacity. Hence, the solution is to bring together the capacity of private justice systems - in order to identify who was responsible - with the will of the public justice system to demand accountability on a principled or controlled basis.

### 4.3 Rejigging the legal system so as to harness internal discipline systems

Adoption of the Accountability Model proposed would require some rejigging of the legal accountability production line. The following components, among others, are envisaged:

- Pyramidal enforcement whereby the legal response to non-compliance can be escalated progressively if necessary.<sup>25</sup> At the base of the pyramid of enforcement reliance is placed on negotiated remedies and penalties with internal disciplinary action being one major requirement which enforcement agencies seek to achieve as a condition of settlement. The options higher up the pyramid include court ordered civil penalties (individual and corporate), with internal disciplinary action as one major element of the penalty imposed. At a higher level again is criminal liability (individual and corporate) with second tier punishment (fines, community service, probation, adverse publicity orders) and with internal disciplinary action being required as a condition of corporate probation. At the apex of the pyramid is first tier criminal liability (jail for individuals; punitive injunctions and corporate capital punishment for corporations) with internal disciplinary action being required as a condition of a punitive injunction as a high priority and top level function to be achieved as a matter of urgency under the direct supervision of all directors. The game theory behind pyramidal enforcement is that the pay-offs are loaded against non-compliance and that strong downwards pressure is exerted towards negotiation and bargaining as the main way in which cases are handled.
- Enforcement and prosecutorial guidelines need to be revised so as to indicate more clearly the circumstances under which corporations and/or individuals are to be prosecuted for offences.<sup>26</sup> The same guidelines should articulate the importance of internal disciplinary action in

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<sup>25</sup> See *CC&A* ch 5; Dellit and Fisse, "Civil and Criminal Liability in Australian Securities Regulation: The Possibility of Strategic Enforcement" in G Walker and B Fisse (eds), *Securities Regulation in Australia and New Zealand* (Auckland: Oxford University Press, 1994).

<sup>26</sup> See *CC&A* 145-6.

enforcement negotiations and settlements and during the sentencing process when conditions of corporate probation are being formulated.

- A statutory framework is needed as a foundation for accountability agreements and internal disciplinary undertakings in negotiated settlements. A statutory framework is also needed for corporate probation and for conditions of corporate probation under which disciplinary and other duties are to be performed by a corporate defendant and relevant personnel.<sup>27</sup> Provisions for supervising and monitoring corporate internal disciplinary responses need to be built into terms of settlements and conditions of corporate probation; the statutory framework should enable such provisions and foster their use by spelling out the main types of protections intended.
- There need to be safeguards against scapegoating and other unjust practices by organisations subjected to accountability agreements or corporate probationary conditions which require internal disciplinary action. The safeguards include independent monitoring and supervision (see above) and the right to complain to the court handling the proceedings (see para 4.5(2) below).

#### **4.4 Main advantages of the Accountability Model**

The Accountability Model is directly responsive to the major problems of accountability specified in paras 2.1 and 2.2 above:

- (1) The slide away from individual accountability apparent in public enforcement systems would be halted. The legal response to corporate crime would be structured so as to make internal disciplinary action a standard objective of enforcement agencies when negotiating penalties as a part of a settlement. A wide spread of individual accountability would be achievable without impinging on the limited resources of enforcement agencies.
- (2) Where corporations are sanctioned for offences, the law would explicitly recognise the importance of individual accountability by providing for corporate probation and by encouraging or requiring courts to make it a condition of corporate probation that internal disciplinary action be taken and verified.

#### **4.5 Potential disadvantages of the Accountability Model**

The Accountability Model raises several understandable yet manageable concerns:

- (1) Will corporations co-operate and undertake genuine internal disciplinary action? Is it safe to put the corporate fox in the chicken coop of

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<sup>27</sup> See ALRC, Report No 68, *Compliance with the Trade Practices Act 1974* (Sydney: ALRC, 1994) 10.5-10.13.



accountability? Although no system of enforced self-regulation can be expected to be totally effective or immune to corporate cheating or obstruction, there are reasons to believe that the Accountability Model would be workable. First, much depends on the array of sanctions which are poised over the heads of those who cheat or fail to comply. The pyramid of enforcement proposed would enable a wide range of possible sanctions to be imposed on individuals and the corporate defendant in the event of non-compliance and this range of sanctions would include sentencing options capable of meeting evasion or intransigence with a no-win pay-off. Secondly, the terms of an internal disciplinary program under negotiated settlements or corporate probation can and should pinpoint those individuals who are responsible for initiating and verifying the corporate defendant's internal disciplinary response. Including some directors and senior managers within those pin-pointed and projecting to them the personalised threat of jail in the event of knowing or reckless non-compliance is likely to concentrate managerial minds on compliance. Thirdly, experience suggests that this approach is feasible. One of many examples is the recent CML case in Australia - 80 employees and agents were dismissed as a result of the internal disciplinary program insisted upon by the Trade Practices Commission as a condition of settlement.<sup>28</sup>

- (2) Won't there be scapegoating of luckless lower level managers or employees by their more powerful superiors? Scapegoating is already a problem but one which has received scant attention. The Accountability Model accentuates the risk of scapegoating but also addresses that risk by providing a range of safeguards.<sup>29</sup> The main safeguards are:
- (a) pyramidal enforcement where scapegoating or related forms of non-compliance are subject to sanctions which can be escalated, if necessary, to a point far beyond the tolerance of rational corporate or managerial self-interest;
  - (b) judicial scrutiny of corporate action when accountability reports are submitted pursuant to accountability agreements, orders or assurances;
  - (c) empowerment of employees with a right to complain about scapegoating to a court and, where relevant, to an internal accountability monitoring committee of the corporate defendant;
  - (d) legal recognition of private systems of justice so as to foster participatory self-determination of issues such as the allocation of responsibility for offences committed on behalf of a corporation; and
  - (e) minimum procedural protections for individuals exposed to internal disciplinary proceedings.

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<sup>28</sup> See CC&A 234.

<sup>29</sup> See CC&A 153-4, 182-7.

(3) Is there an inegalitarian bias in favour of corporate managers who, unlike street offenders, are able to avoid the stigmatic process and often more severe forms of punishment meted out to them in our criminal justice system? The Accountability model should not be misunderstood:<sup>30</sup>

- Under the Accountability Model, those who commit serious offences are subject to prosecution. What counts as a serious offence requires some refocussing and redefinition of enforcement priorities but that is consistent with the view that the criminal law has been over-used as a mechanism of social control.
- Equality before the law can be a misleading slogan unless interpreted and applied with due sense of enforcement realities. More suspects can be dealt with and held accountable by internal disciplinary means than would be possible if the same finite resources were used for the much more costly process of prosecution. For less serious offences, the policy choice lies between: (1) allocating resources to the prosecution of a relatively small number of cases; or (2) widening the accountability net and relying on internal disciplinary sanctions as a complementary aid. Either way, the outcome is inconsistent with equality before the law but option (2) gives “a bigger bang for the buck”.

## 5. *Conclusion: beyond corporate personality and towards accountability*

- 5.1 **All who are responsible for corporate crime should be held responsible.** This ideal is approachable only if legal systems recognise corporate systems of justice, exploit their capacity for delivering individual accountability, and channel their power. There is no future in trying to rely exclusively on individual criminal liability or individual civil penalties via prosecutions and enforcement proceedings.
- 5.2 The Accountability Model briefly outlined here raises many questions of design, application and ultimate worth. The aim of this paper has been to highlight the major problems of accountability which now arise in the social control of corporate crime and to signal a promising way of resolving those problems. A more detailed account and assessment of the Accountability Model is available elsewhere.<sup>31</sup>
- 5.3 Accountability is hardly the only dimension of corporate crime which presents a challenge. However, traditional issues of corporate personality and corporate punishment are fast being resolved. Discussion and debate needs to be re-centered. The largest black hole in the social control of corporate crime is the feasibility of arriving at what most of us well understand and value as accountability. The strongest gravitational pull comes from the private justice systems of organisations. These open up the

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<sup>30</sup> See CC&A 178-182.

<sup>31</sup> See CC&A.

possibility of converting the corporation into something Ambrose Bierce never dreamed of - an ingenious device for the maximisation of accountability.