Criminal Sentences for Corporations: Alternative Fining Mechanisms

Edward Alsworth Ross once lamented that a corporation "is an entity that transmits the greed of investors, but not their conscience; that returns them profits, but not unpopularity."[1] Committed to infliction of pain as its primary weapon against crime, the law has been particularly confounded by the screening mechanism of the corporate form. Who will feel the pain of a sanction imposed on a corporation? On one occasion the answer may seem to be no one at all; on the next, the penalty may fall all too heavily on a broad selection of seemingly innocent bystanders. In any event, the law's most powerful coercive tools—the threats of imprisonment and capital punishment—are of no avail against an institution.[2]

Two weapons have carried the brunt of the fight against corporate crime: the fine levied on the corporation itself, and the threat to bypass the entity and prosecute individual managers or employees.[3] These two approaches are not mutually exclusive. They can be, and often are, employed side by side to sanction a single illegal act.

This Comment explores the enforcement possibilities of corporate fines as companions to individual penalties. Part I reformulates the rationale for these fines, suggesting that individual and corporate prosecutions are not so much parallel means to a single end as tools with complementary but distinct functions. Part I also offers a revised framework for justifying the harm fines cause to innocent or impotent shareholders. Part II evaluates the performance of the traditional cash fine in the context of this altered rationale. Parts III and IV explore three variants that, like the traditional fine, impose a financial penalty upon conviction of the corporation. These alternatives are the equity fine, a penalty levied in stock; the pass-through fine, a penalty levied on shareholder assets; and superadded liability, an alteration of the rules of limited liability in the

1. E. Ross, Sin and Society 109-10 (1907).

2. In fact, the sentencing of corporations has run the full gamut of anthropomorphic parallels to individual sentencing, including both "death" to and "imprisonment" or "incapacitation" of the entity. *See infra* note 10. But these are economic penalties at bottom.

3. In recent years a third approach, corporate probation, has been applied in a handful of cases. *See, e.g.*, United States v. Mitsubishi Int'l Corp., 677 F.2d 785 (9th Cir. 1982); United States v. Wright Contracting Co., 563 F. Supp. 213 (D. Md. 1983), *vacated*, 728 F.2d 648 (4th Cir. 1984); State v. Shepherd Constr. Co., 248 Ga. 3, 281 S.E.2d 151, *cert. denied*, 454 U.S. 1055, *appeal dismissed*, 454 U.S. 1074 (1981); *see also* Note, *Structural Crime and Institutional Rehabilitation: A New Approach to Corporate Sentencing*, 89 Yale L.J. 353, 368 n.92 (1979). A requirement of community service sometimes accompanies such probation orders. *See infra* note 10.

criminal context. Though none of these variants can stand on its own as a full alternative to cash fines and individual prosecutions, this Comment urges that, as part of a diversified strategy for the prevention of corporate misconduct, each can serve as a useful arrow in society's quiver.

A preliminary word is in order regarding the sort of misconduct and the kind of judgment to which these proposals are addressed. The fining alternatives explored here operate independently of criminal stigma and criminal burden of proof. They could be imposed in a civil proceeding; this Comment makes no judgment as to the proper procedure for their administration.[4]

The discussion employs the word "criminal" to refer to a type of conduct rather than a type of judgment. A criminal act, as defined here, is conduct[5] that would traditionally be regarded as uniformly blameworthy if engaged in by an individual. A paradigm of such conduct is bribery of a domestic government official: As an offense that threatens the fundamental integrity of our system, the law aims to stamp it out altogether, rather than to restrict its use to occasions when it is particularly profitable.[6] Indeed, the greater the profit in such an offense, the stronger the need to deter it.

Contrasting with this paradigm of conduct without the possibility of redeeming virtues is the regulatory offense.[7] One might, for example, penalize an actor for spilling effluent into a river, but set the penalty so as

4. For useful discussions of that issue, see Leigh, *The Criminal Liability of Corporations and Other Groups: A Comparative View*, 80 MICH. L. REV. 1508 (1982); Note, *A Proposal to Restructure Sanctions Under the Occupational Safety and Health Act: The Limitations of Punishment and Culpability*, 91 YALE L.J. 1446, 1450-54 (1982).

5. In most American jurisdictions, "conduct" is attributed to a corporation if it is performed by a corporate agent—at any level in the hierarchy—within the general scope of the agent's authority and with intent to benefit the firm. *See, e.g.*, Standard Oil Co. v. United States, 307 F.2d 120, 127-28 (5th Cir. 1962); St. Johnsbury Trucking Co. v. United States, 220 F.2d 393, 398-99 (1st Cir. 1955) (Magruder, C.J., concurring); *see also* United States v. Harry L. Young & Sons, 464 F.2d 1295, 1296-97 (10th Cir. 1972) (mere fact that agent violated instructions does not defeat corporate liability). *See generally* 1 K. BRICKEY, CORPORATE CRIMINAL LIABILITY §§ 3:04, 3:07, 4:01-4:02 (1984). A few jurisdictions and the Model Penal Code restrict corporate responsibility for serious crimes to acts performed or condoned by high managerial officials, on the view that a broader sweep of liability is unfair to the corporation and those behind it. *See, e.g.*, State v. Adjustment Dep't Credit Bureau, Inc., 94 Idaho 156, 158-60, 483 P.2d 687, 689-91 (1971); MODEL PENAL CODE § 2.07 (Tent. Draft No. 4, 1955).

The fining alternatives proposed in this Comment are consistent with both the expansive mainstream view of liability and with more restrictive approaches. They are founded on a conception of the corporate fine, explained in Part I, that is largely divorced from notions of punishment or culpability. The fairness considerations that animate the debate over the scope of corporate responsibility do not come into play.

6. The category of absolute prohibitions also includes most varieties of fraud, violations of some antitrust and national security restrictions, as well as theft, embezzlement, and similar offenses.

7. For a similar division of corporate offenses, see Kadish, *Some Observations on the Use of Criminal Sanctions in Enforcing Economic Regulations*, 30 U. CHI. L. REV. 423, 424 (1963). *See generally* Cooter, *Prices and Sanctions*, 84 COLUM. L. REV. 1523, 1524-31, 1548-50 (1984).

not to deter a violation of the statute if sufficiently compelling economic considerations argued against prevention of the spill. Here great profit to the violator negates the need for deterrence, rather than enhancing it. Current law—with questionable wisdom[8]—includes under the rubric of criminal law some violations within the regulatory sphere. This Comment does not, however, address the proper treatment of conduct calling for something less than an absolute prohibition. While some punishment concepts straddle the two fields, there are essential differences. Naturally, the means of calculating a fine meant to enforce an absolute prohibition will differ from that of a fine desigued only to regulate.[9] Where the considerations at work in the two spheres overlap, however, this Comment will borrow illustrative cases from the regulatory sphere.

I
RETHINKING THE RATIONALE FOR THE CORPORATE FINE

Courts today almost invariably respond to corporate convictions by fining the corporation.[10] There seems to be no consensus among courts

8. For useful discussions of the advisability of criminalizing such conduct, see Kadish, *supra* note 7; Wheeler, *The Use of Criminal Statutes to Regulate Product Safety*, 13 J. LEGAL STUD. 593 (1984).

9. This divergence is explained *infra* in note 15. Another area of divergence between criminal and regulatory fines is pointed out *infra* in note 44.

10. To some, the fine has seemed the only sanction applicable to an organization. *See, e.g.*, United States v. Alton Box Board Co., 1977-1 Trade Cas. (CCH) ¶ 61,336, at 71,163 (N.D. Ill. 1977); Kadish, *supra* note 7, at 434. There are several alternatives, however. At least two of them, corporate probation and community service, have current vitality as judicially imposed sanctions.

Instances of the use of corporate probation are listed *supra* in note 3. The efficacy of probation is limited to the supervisory capacity of the court. Under the current federal statute, moreover, its usefulness depends on the availability of strong alternative sanctions, for a defendant corporation is free to refuse probation. United States v. Mitsubishi Int'l Corp., 677 F.2d 785, 788-89 (9th Cir. 1982); 18 U.S.C. § 3651 (1982). Probation may also be inefficient. In contrast to the spot-cheek enforcement sufficient in a system based on fines, probation calls for monitoring of the corporation's activities by both the court and the company's management.

In 1981 Professor Fisse advanced community service as an alternative to fines and probation for sanctioning corporations. Fisse, *Community Service as a Sanction Against Corporations*, 1981 WIS. L. REV. 970. Since his article appeared, several courts have implemented his suggestion as a condition of probation, ignoring his advice that probation would be a poor vehicle by which to impose such a sanction. *See* United States v. William Anderson Co., 698 F.2d 911 (8th Cir. 1982); *Mitsubishi*, 677 F.2d at 787 n.1; United States v. Danilow Pastry Co., 563 F. Supp. 1159, 1166-67, 1171-72 (S.D.N.Y. 1983). For a discussion of a pitfall that applies to the use of community service sanctions, see *infra* notes 84-85 and accompanying text.

A third alternative, dissolution of the corporation under a writ of *quo warranto*, has been proposed and—in the past—occasionally applied as a sanction. *See, e.g.*, Standard Oil Co. v. Missouri, 224 U.S. 270 (1912) (Missouri antitrust statute provided for forfeiture of franchise by violators); MODEL PENAL CODE § 6.04 & comment (Tent. Draft No. 4, 1955). Such a sanction is all too powerful in some contexts and ineffectual in others; it is too rigid to be of great value. Investors might evade its consequences by shifting their enterprise to a new entity. In any event, the wealth boundary shortcoming of fines, *see infra* text accompanying notes 62-67, is even more serious for a penalty of dissolution, as investors would stand to lose only the difference between the market and as to the rationale for these fines, however, nor as to the means of calculating an appropriate fine for a particular offense. Sentencing judgments respond to a broad array of considerations, whose relative weights and underlying justifications are rarely spelled out.[11]

The mainstream of commentary, on the other hand, has settled on a utilitarian rationale for the corporate fine, with deterrence as its centerpiece.[12] Economists have proceeded a step further, arriving at a formula for determining the penalty that would deter a rational corporation in any given circumstances. The fairness and usefulness of fines calculated according to this formula, however, have been called into question both by the innocence of most of those they ultimately penalize and by the apparent incompleteness of the rational model for corporate decisionmaking. This Part first treats the usefulness of these theoretically ideal fines, and then analyzes their fairness.

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liquidation values of the concern. Overspill to innocent parties, *see infra* text accompanying notes 45-50, poses a grave difficulty as well.

A fourth alternative that often would present similar drawbacks might loosely be termed "corporate imprisonment." In 1982 the Japanese Health Ministry, responding to drug marketing violations, shut down Nippon Chemiphar for 80 days, sealing its plants and warehouses. The company, which prior to this action boasted $100 million in annual sales, suffered a precipitous decline on the stock market. *Euthanasia*, THE ECONOMIST, Dec. 11, 1982, at 82. The U.S. Department of Agriculture often accomplishes a similar result by withdrawing for a specified or occasionally indefinite period the right of corporate felons to receive the USDA inspection required for selling meat. Many of these companies have no other line of business. Losses from the shutdowns have sometimes reached several million dollars. Telephone interview with Harold J. Reuben, Deputy Assistant General Counsel, U.S. Department of Agriculture, Washington, D.C. (Feb. 20, 1985); *see also* Toscony Provision Co. v. Block, 538 F. Supp. 318 (D.N.J. 1982); 21 U.S.C. § 671 (1982).

Adverse publicity offers yet another means of penalizing a corporation. *Compare* Fisse, *The Use of Publicity as a Criminal Sanction Against Business Corporations*, 8 MELB. U.L. REV. 107 (1971) (advocating publicity sanctions), *with* Coffee, *"No Soul to Damn, No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 424-34 (1981) (critique of publicity sanctions). *See also* United States v. Hospital Monteflores, Inc., 575 F.2d 332, 335 (1st Cir. 1978).

11. Sentencing judgments seem to be guided primarily by a seat-of-the-pants assessment of deterrence, sometimes coupled with a sense of just deserts based on considerations such as the seriousness of the harm done, the size of the corporation, and the economic pressures that induced the resort to criminal methods. *See, e.g.*, United States v. Danilow Pastry Co., 563 F. Supp. 1159 (S.D.N.Y. 1983); In re Grand Jury Investigation of Cuisinarts, Inc., 516 F. Supp. 1008, 1010 (D. Conn.), *aff'd*, 665 F.2d 24 (2d Cir. 1981), *cert. denied*, 460 U.S. 1068 (1983); United States v. Charmer Indus., Inc., 1981-1 Trade Cas. (CCH) ¶ 64,145, at 76,865 & n.2 (E.D.N.Y. 1981); United States v. Greyhound Corp., 370 F. Supp. 881, 883-85 (N.D. Ill.), *aff'd*, 508 F.2d 529 (7th Cir. 1974); State v. Lawn King, Inc., 152 N.J. Super. 333, 341-43, 377 A.2d 1214, 1218-19 (1977), *rev'd on other grounds*, 169 N.J. Super. 346, 404 A.2d 1215 (1979), *aff'd*, 84 N.J. 179, 417 A.2d 1025 (1980).

12. *See* Coffee, *Corporate Criminal Responsibility*, in 1 ENCYCLOPEDIA OF CRIME AND JUSTICE 253, 258 (S. Kadish ed. 1983) (similar characterization of consensus); *see also, e.g.*, C. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 30-31 (1975). There are a few dissenters. *See, e.g.*, *Developments in the Law—Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1231-41 (1979) (suggesting that retribution also plays a role) [hereinafter cited as *Developments—Corporate Crime*].

A. *The Economists' Model: Deterring the Rational Corporation*

To ensure lawful behavior by rational firms, it is insufficient to levy penalties that simply remove the ill-gotten gains of prohibited conduct. Effective deterrence requires a prospective view of criminal risk. The fine must reduce the expected gain[13] of a violation to zero or below,[14] incorporating a multiplier to counterbalance the possibility that a violation would escape detection.[15] Consider, for example, a risk-neutral[16] corporation presented with an opportunity to procure by bribery a government contract that will bring in a profit of $50,000. If the firm perceives a ten-percent risk of conviction, it will assign a penalty of $50,000 a discounted or expected value of $5,000. Only a penalty in excess of $500,000 will certainly deter a profit-maximizing corporation; any lower penalty leaves a positive net expected gain.[17]

The calculation of an effective deterrent is independent of the harm caused by an illegal act,[18] which in the paradigm case of a bribe might be difficult to quantify. This is not to say that harmfulness could have no

13. As used in this Comment, "expected gain" refers to the objective prospect for gain from a criminal act, as assessed by a court with the benefit of hindsight. The subjectively perceived expected gain of the corporation at the time of the wrongdoing is irrelevant at the time of sentencing. For effective deterrence rational corporations need only know that the true expected gain of criminal conduct will always prove, in the end, to have been zero. Hence a "corporate" crime having no real likelihood of producing gain merits no corporate fine, and is solely a matter for individual sentencing.

"Gain" encompasses both direct profits from an illegal enterprise and costs saved by failure to implement internal controls to guard against illegality.

14. From the standpoint of deterrence alone, a negative expected gain is the better goal. *See* R. POSNER, ECONOMIC ANALYSIS OF LAW § 7.2, at 166 (2d ed. 1977). *But cf. infra* text accompanying note 44.

15. *See* R. POSNER, *supra* note 14, § 7.2, at 164-67; Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968) (same concept in context of regulatory fines); Coffee, *supra* note 10, at 389. The nondetection factor encompasses both unprosecuted violations and unsuccessful prosecutions.

Fines aimed at regulatory violations, as defined *infra* in text accompanying notes 7-8, must conform to a fundamentally different model. The text describes the minimum fine adequate to enforce an absolute prohibition against a rational corporation. That fine is the product of two factors: the potential gain of illegal conduct multiplied by the reciprocal of the likelihood of conviction. For a regulatory offense, however, one must replace the factor of potential gain with a factor equal to the potential harmfulness of the conduct to society. A fine pegged to expected harm rather than expected gain allows the nominally proscribed conduct to proceed if it yields economic benefits exceeding the harm it causes. For a discussion of the regulatory fine, see Note, *Deterring Air Polluters Through Economically Efficient Sanctions: A Proposal for Amending the Clean Air Act*, 32 STAN. L. REV. 807, 812-14 (1980). *See generally* Cooter, *supra* note 7.

16. Where the nondetection factor is significant, the fine required to deter a violation may be somewhat higher for a risk-preferring firm and lower for a risk-averse firm. *See* Note, *supra* note 15, at 812-13 nn.25, 27 & 29.

17. For an example of a corporation that seems to have governed its conduct on the basis of such a calculation, see People v. Mature Enters., Inc., 73 Misc. 2d 773, 776, 343 N.Y.S.2d 934, 937 (Crim. Ct. 1973), *aff'd*, 76 Misc. 2d 660, 352 N.Y.S.2d 346 (Sup. Ct.), *modified*, 35 N.Y.2d 520, 323 N.E.2d 704; 364 N.Y.S.2d 170 (1974).

18. *But cf. supra* note 15.

role in calculating deterrent penalties. One might discourage a very harmful act with a penalty far in excess of the theoretically adequate level for deterrence. The higher penalty would provide a margin of safety should a potential violator's calculus be warped, and induce extraordinary internal controls to ensure compliance. But the fine that reduces expected gain to zero is the minimum that provides effective deterrence of a rational firm, at least if it is the only sanction imposed.[19] Of course, the determination and imposition of minimum effective fines would often be an inexact process. That would not always be so, however; where enforcement is accomplished by a program of random inspections, for example, the risk of apprehension might be readily quantifiable.[20]

B. Shareholders as the Central Target of Fines

The deterrence model for the rational firm treats the corporation as though it were a person: the firm *perceives* a risk and *calculates* its expected gain. Of course, human beings perform these acts for the corporation. If a corporation is rational, people are the locus of that rationality, and it follows that people are the ones who ultimately must be deterred. But which human beings are the real target of the deterrence? The firm's managers[21] come immediately to mind. After all, they promulgate the corporate policies that cause, prevent, encourage, or discourage criminal conduct. Yet managers are relatively untouched by the direct economic effects of a corporate fine.[22]

It is shareholders who bear the full economic burden of almost every fine imposed. To be sure, a fine levied in cash[23] distributes indirect burdens rather haphazardly over a wide variety of human actors. Managers may suffer economic harm if, for example, they lose their jobs owing to bankruptcy or an internal upheaval occasioned by the fine. Others may be hurt as well, particularly if the fine is severe.[24] But each dollar of fine directly reduces the value of the shareholders' investment by at least a dollar. Indeed, the reduction often is even greater, for a fine can induce a

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19. This concept is meaningful even where the corporation is merely negligent. If negligent conduct were to produce gain for the corporation, it would hardly make sense to take precautions against it. *Cf.* Note, *Criminal Liability Without Fault: A Philosophical Perspective*, 75 COLUM. L. REV. 1517, 1538 n.88 (1975).

20. *See* Note, *supra* note 15, at 818.

21. The performance of managers remains a concern even when the acts of lower echelon employees render a firm liable; such acts might be prevented by improved internal controls. *Cf. supra* note 5.

22. The indirect effects on management of such a fine are discussed *infra* in text accompanying notes 33-35, 68-69, 99, and text following note 100.

23. Non-cash fines, an untried alternative to the traditional cash fine, are discussed *infra* in Parts III through V.

24. *See infra* text accompanying notes 45-50.

liquidity crisis that multiplies its effect.[25]

A number of commentators have suggested instead that penalized firms simply raise prices to recoup their shareholders' loss.[26] But if these corporations can increase their surplus by raising prices, it is difficult to imagine why they would not have done so before the imposition of the fine. The firm in a competitive market that raises its prices will lose sales to a competitor; the monopolist that raises prices will simply lose sales.[27] If that were not the case, these companies would happily have reaped the benefits of higher prices without the catalyst of a fine. In other words, regardless of whether a market is concentrated or unconcentrated, a rise in cost to a single firm in that market does not *create* a possibility of increasing revenue by raising prices.

Shareholders ordinarily experience the resulting loss in the form of lowered share values. Of course, other factors affecting share prices may mask this effect. In some cases, moreover, the loss caused by a fine too small to attract the notice of the market will not be realized until later, when the diminished value of the corporation's assets, alone or together with other factors, alters some future valuation of its shares. But however small the fine or vast the corporation, the shareholders do not escape loss.[28]

C. Criticism of the Rational Model: The Innocence and Impotence of Shareholders

That shareholders are the central human targets of corporate fines has been the principal obstacle to the development of a coherent rationale for these fines. To be sure, shareholders are in theory the ultimate

25. *Cf. infra* text accompanying notes 92-93 and Figure 1.

26. *E.g.*, G. WILLIAMS, CRIMINAL LAW: THE GENERAL PART § 283, at 864 (2d ed. 1961); Comment, *The Criminal Responsibility of Corporate Officials for Pollution of the Environment*, 37 ALB. L. REV. 61, 62 (1972); Note, *supra* note 3, at 363; *see also* State v. Chapman Dodge Center, Inc., 428 So. 2d 413, 419 (La. 1983).

27. *Cf.* Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499, 524 (1961) (monopolist attempting to pass on cost of tort judgment would lose sales).

28. There are four circumstances in which the shareholders may escape part or all of the burden. First, they may escape if the corporation is a regulated monopoly such as a utility, and the regulating commission authorizes a rate increase that covers the fine. *See* Note, *Increasing Community Control Over Corporate Crime—A Problem in the Law of Sanctions*, 71 YALE L.J. 280, 285 n.17 (1961). In this case, regulation has kept the monopolist's prices artificially low prior to the fine. Second, price increases may absorb the fine where all members of a competitive industry receive a like fine. *See Developments—Corporate Crime, supra* note 12, at 1372 n.37. If only some members of a competitive but concentrated industry suffer a fine, there may nonetheless be an opportunity for all survivors—including some of those fined—to raise prices if the fine bankrupts one of the penalized firms. Third, if a fine renders the corporation insolvent, the loss to the shareholders is limited to the market value of the firm, even if that is lower than the fine. This third and most significant exception to the general rule is discussed *infra* in text accompanying notes 62-67. Finally, transactions in put and call options can limit a shareholder's exposure. These purchased transfers of risk do not affect the performance of fines. *See infra* note 105.

authority in the corporation. But as a practical matter, in the publicly held enterprises that control the bulk of American industry, the average shareholder is nearly powerless to monitor or control management.[29] Many such enterprises can be described as management controlled, without a single stockholder of sufficient stature to form the nucleus of a vote that could challenge management. Even close corporations may have a number of powerless stockholders, while the major stockholders in closely held firms ordinarily hold positions in management and could as easily be coerced through sanctions aimed directly at individual managers.

The central difficulties in justifying corporate fines spring from this separation of ownership from control. First, most shareholders cannot fairly be seen as culpable with respect to corporate misconduct. Second, they may not be relied upon to bring about reform after a conviction. Their very weakness, moreover, undermines the basic assumption of economic rationality underlying the economists' vision of the fine's effect on the corporate entity. Managers insulated from the shareholder body may for reasons of their own undertake criminal conduct that, while lucrative enough in itself, is subject to a risk of penalty that prevents it from being a profit-maximizing course.[30] A broad array of personal motives can submerge the goal of shareholder profit where the shareholders lack the strength to enforce their interests.[31]

D. *The Usefulness of Rational Fines for Semirational Corporations*

In evaluating the obstacles to a satisfactory rationale for corporate fines, it is first important to define the sort of deterrence that is their goal. The word "deterrence" is perhaps misleading in the corporate context, since it connotes crime prevention through fear. But corporate fines deter not so much through fear as through cancellation of motive. The essence of fines that eliminate expected gain is simply the neutralization of one of the stimuli for corporate crime: the profit motive.

While the pursuit of profit for shareholders is not the sole considera-

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29. *See generally* Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 33-40 (1969); Hetherington, *When the Sleeper Wakes: Reflections on Corporate Governance and Shareholder Rights*, 8 HOFSTRA L. REV. 183, 184-85 & n.2 (1979). *Cf. infra* text accompanying note 33 (such dispersed ownership confined primarily to largest corporations).

30. *See, e.g.*, F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 31-33 (1970); C. STONE, *supra* note 12, at 38; Kamerschen, *The Economic Effects of Monopoly: A Lawyer's Guide to Antitrust Economies*, in ECONOMIC ANALYSIS AND ANTITRUST LAW 20, 28-32 (T. Calvani & J. Siegfried eds. 1979).

31. For discussions of the range of motives that animate corporate managers, see, for example, J. GALBRAITH, THE NEW INDUSTRIAL STATE 133-86 (3d ed. 1978); F. SCHERER, *supra* note 30, at 31-33; Donaldson, *Financial Goals: Management vs. Stockholders*, HARV. BUS. REV., May-June 1963, at 116.

tion that motivates a corporation's management, it remains a significant element in corporate decisions.[32] In the great majority of firms, including an important minority of the largest ones, the shareholder body is not so fragmented as to lose *all* influence over management.[33] Even where the risk of a direct challenge to management is minimal, executives must reckon that an unhappy stockholder population brings lower stock prices. When stock performs poorly, a manager's value on the job market may fall,[34] as may the value of his stock options; moreover, the danger of ouster through a hostile takeover increases.[35] Finally, though their devotion may not be singleminded, many managers—some of whom are themselves substantial shareholders—serve shareholder interests out of loyalty. Indeed, the legal system expends considerable effort to enforce a fiduciary duty that corporations be operated for the financial benefit of stockholders. It would be anomalous to allow illicit conduct to benefit shareholders, while at the same time penalizing management for engaging in it.

In short, the rationality of the corporation is imperfect, but profit maximization remains a key element in corporate decisionmaking. The deterrence postulated for rational corporations at the beginning of this section likewise is imperfect for the semi-rational corporations of the real world, but it retains potential to reduce the incidence of crime by eliminating one of its several motives.[36]

The complementary roles of corporate and individual penalties are now apparent. Prosecution of individual corporate agents serves to combat the other motives for organizational crime—the personal motives of management. Just as the motives may be mixed, so must the two avenues of prosecution be used in tandem. Reliance on corporate penalties alone ignores the complexity of corporate decisionmaking. Reliance on only individual penalties leaves the profit motive in place as a stimulus for corporate crime.

32. For elaboration of this point, see, for example, Hetherington, *supra* note 29, at 184-85 & n.3.

33. *See* Eisenberg, *supra* note 29, at 33-43.

34. *See* Lewellen & Huntsman, *Managerial Pay and Corporate Performance*, 60 AM. ECON. REV. 710 (1970) (study of 50 major firms showing correlation between profitability and share values on the one hand and executive compensation on the other).

35. *See* Eisenberg, *supra* note 29, at 57-59.

36. In addition to this core function of eliminating the profit motive for corporate misconduct, corporate fines often serve in secondary roles. They provide a means of handling occasions when responsibility for an act is so dispersed across the organization that no individual would exhibit the required mens rea, *see, e.g.*, United States v. T.I.M.E.-D.C., Inc., 381 F. Supp. 730, 738-39 (W.D. Va. 1974), or when the identities of those who did form the necessary mens rea are impossible to ascertain, *see, e.g.*, Commonwealth v. Beneficial Fin. Co., 360 Mass. 188, 274-75, 275 N.E.2d 33, 81-84 (1971), *cert. denied*, 407 U.S. 914 (1972). For additional benefits of corporate fines, see, for example, Coffee, *supra* note 10, at 387 & n.6.

E. Are Fines Keyed to Expected Gain Unfair?

Notwithstanding its usefulness in reducing the incidence of corporate crime, the rational fine might be unjustifiable because of its indiscriminate penalization of shareholders who are not culpable. Some commentators have defended the corporate fine by suggesting that it merely deprives each shareholder of unjust enrichment.[37] Others observe that this rationale accounts only for fines set no higher than the profit actually gained by the illegal act, leaving criminal conduct prospectively attractive to the corporation that maximizes profits.[38] But while many shareholders are innocent, it does not follow that it is unjust to penalize them vicariously to the full extent of their expected gain from corporate crime, even if that penalty entails a fine of many times their actual gain.

Those who criticize corporate fines for penalizing innocent stockholders view the penalty from the wrong temporal perspective. Shareholders buy into and hold investments while looking at investment risk prospectively. A fine that nullifies expected gain merely counterbalances the positive side of a shareholder's risk equation: the chance that his corporation will engage in criminal activity and will escape undetected. Each side of this equation will therefore have an equivalent present value when viewed prospectively.

When one innocent shareholder suffers great loss, while another escapes without penalty and with the fruits of his corporation's undetected criminal conduct as well, both are merely playing out a zero-sum game of chance. By purchasing or continuing to hold shares that may fortuitously yield him the benefits of illicit conduct, each shareholder, however innocent, assumes the risk that his corporation will suffer the misfortune of a conviction. He is like the buyer of a raffle ticket, who in return for possible gain assumes the risk that his ticket will prove to be worthless.

The innocent shareholder is in a very different position from other innocent actors—such as employees and suppliers—who, as Part II will show, may be hurt by the broad sweep of a corporate fine. These innocents can ordinarily look forward to no prospect of gain from undetected illegal conduct that would counterbalance the risk of a fine. And while the possibility of large fines introduces an added element of risk into the shareholder's investment, shareholders are uniquely situated to neutralize risk through diversification. What is more, this risk will have been reflected in lower share prices when the investor bought his shares.[39] Hence the view that shareholders are "innocent"[40] should be

37. *E.g.*, Edgerton, *Corporate Criminal Responsibility*, 36 YALE L.J. 827, 837 (1927).

38. *E.g.*, Coffee, *supra* note 12, at 257-58. *Cf. supra* text accompanying notes 13-17.

39. Current prices do not reflect such a risk; these lower share prices would prevail once the market came to expect larger fines.

no bar to fines that eliminate the prospective profit in criminal conduct.[41] In a word, the innocence of shareholders is irrelevant.

Indeed, the rational fine not only respects the fairness interests of shareholders, but it reaches a just outcome for society at large. As the foregoing analysis suggests, unless fines nullify the expected gain of crime, shareholders receive a windfall in the form of elevated share values. If a fining system were instituted to bring this prospective gain to

40. *E.g.*, G. WILLIAMS, *supra* note 26, § 283, at 863; Fisse, *Reconstructing Corporate Criminal Law: Deterrence, Retribution, Fault, and Sanctions*, 56 S. CAL. L. REV. 1141, 1219, 1237 & n.462 (1983); Comment, *Is Corporate Criminal Liability Really Necessary?*, 29 SW. L.J. 908, 927 (1975). *See also* State v. Chapman Dodge Center, Inc., 428 So. 2d 413, 419 (La. 1983).

41. The foregoing analysis must be distinguished from the simple unjust enrichment rationale commonly advanced as a justification for fines, a rationale that examines violators retroactively rather than prospectively. *Cf.* Coffee, *supra* note 10, at 417 (criticizing this traditional rationale). For what may be a hint of the analysis offered here, see *Developments—Corporate Crime*, *supra* note 12, at 1372 n.37.

Courts today clearly do not adhere to the model advanced in the text in setting fines. While the defendant's gain often plays a role in sentencing, *see, e.g.*, United States v. Association of Am. Battery Mfrs., 1954 Trade Cas. (CCH) ¶ 67,637, at 69,040 (W.D. Mo. 1953), the cases do not explicitly couple this element with an evaluation of the risk of detection. In view of the nominal amount of many corporate fines, it is difficult to imagine that they could nullify the prospective gain of the potentially lucrative conduct they penalize. *See, e.g.*, United States v. Richardson-Merrell, Inc., Crim. No. 1211-63 (D.D.C. June 4, 1964), *cited and described in* C. STONE, *supra* note 12, at 55-56 & n.18 ($80,000 fine for violation resulting in more than $7,000,000 in added sales); People v. Mature Enters., Inc., 73 Misc. 2d 773, 781, 343 N.Y.S.2d 934, 941-42 (Crim. Ct. 1973) (fine of $100,000 for conduct netting firm $153,000 profit), *aff'd*, 76 Misc. 2d 660, 352 N.Y.S.2d 346 (Sup. Ct.), *modified*, 35 N.Y.2d 520, 323 N.E.2d 704, 364 N.Y.S.2d 170 (1974).

Often, penalty maxima have capped corporate liability at absurdly low levels. For an example, see United States v. Amrep Corp., 560 F.2d 539, 543 (2d Cir. 1977), *cert. denied*, 434 U.S. 1015 (1978), together with the discussion of maximum penalties in the related case of United States v. Amrep Corp., 425 F. Supp. 460 (S.D.N.Y.) (maximum penalty of $70,000 in $170,000,000 land sales fraud), *rev'd on other grounds*, 545 F.2d 797 (2d Cir. 1976), *aff'd mem.*, 573 F.2d 1296 (2d Cir. 1977). But a number of legislatures have moved in the direction of fines specifically designed to cut expected gain to zero by discarding absolute limits in favor of maxima pegged at a multiple of—usually double—the gain from the prohibited conduct. *See, e.g.*, DEL. CODE ANN. tit. 11, § 4208 (1974); FLA. STAT. ANN. § 775.083(1)(f) (West 1976); N.Y. PENAL LAW § 80.00 (McKinney Supp. 1984); OR. REV. STAT. § 161.655(3) (1983); *see also* MODEL PENAL CODE §§ 6.03, 6.04 & commentary (Tent. Drafts Nos. 2 & 4, 1954-55); U.S. Dep't of Justice, *Guidelines for Sentencing Recommendations in Felony Cases Under the Sherman Act*, 20 CRIM. L. REP. (BNA) 3071, 3076 (Feb. 24, 1977).

Elsewhere, legislatures have apparently built a hedge against nondetection into the tort remedy by providing for multiple recovery by private plaintiffs. In such contexts as antitrust, therefore, a sentencing court should temper the penalty to reflect the outcome or likely outcome of parallel civil litigation. *Cf.* United States v. Minneapolis Elec. Contractors Ass'n, 1953 Trade Cas. (CCH) ¶ 67,662, at 68,964 (D. Minn. 1953) (reduction of fines after settlement of treble-damage lawsuit). With respect to criminal as opposed to regulatory misconduct, this kind of transfer of deterrence to the private sphere is possible only where private suits will lie, and where either (1) the plaintiff's damages will parallel the defendant's gain, so that multiple recovery can bear a relationship to expected gain, or (2) punitive damages are available and could be pegged to expected gain. Some commentators have argued persuasively, however, that a system of fines aimed at nullifying expected gain is more rational and effective than reliance on multiple damage private actions. *See* K. ELZINGA & W. BREIT, THE ANTITRUST PENALTIES: A STUDY IN LAW AND ECONOMICS 112-16 (1976); Coffee, *supra* note 10, at 403-04.

zero, the market values of all outstanding shares would roughly equal what their values would be in a world free of corporate crime.[42] When fines are set at a lower level, stock values settle at a higher one, reflecting the positive net contribution to corporate treasuries from criminal activity. The concept of unjust enrichment dictates a return of these windfall funds to the victims of corporate crime. A fining scheme instead channels the funds to the state. But since society at large is a principal victim of the sort of crime this Comment addresses, the state is an appropriate depository for these funds. Fines therefore serve to correct a maldistribution of wealth brought about by crime.[43]

Of course, the fairness concerns that encourage fines set at the deterrence optimum discourage fines in excess of that amount. From the standpoint of deterrence alone, it is tempting to provide for a negative expected return for criminal conduct. The negative return would, after all, provide a better prophylactic against crime than a return of zero. But the argument for additional penalization becomes weaker once expected return has reached zero and criminal conduct no longer improves the risk equation of innocent shareholders. Fairness concerns begin to cut against the utilitarian benefits of corporate fines. And in general, individual penalties for individual managers should be adequate to supply additional deterrence once the profit motive has been eliminated.[44]

II
THE DEFECTS OF CASH FINES

After calculating the optimum fine, one must determine the appropriate mechanism for levying it. The cash fines in use today suffer from crippling flaws. They are inaccurate tools, hurting innocent parties other than shareholders. This inaccuracy calls their fairness into question. At the same time, other features undermine their deterrent effectiveness. These flaws, as developed below, will be the focus of the attempt later in this Comment to construct superior mechanisms for levying corporate fines.

42. Share values in the hypothetical world free of corporate crime would be slightly higher, because those shares would lack the element of risk inherent in corporations exposed to fines.

43. A decision to forego recovery of this wealth could be regarded as a subsidy to investment. An investment subsidy to limit risk, however, should provide insurance for all such risks, rather than cushion only those arising from criminal conduct.

44. *Cf. supra* notes 9, 15 and accompanying text. This is another example of the divergence between criminal and regulatory fines. To add individual penalties to an optimal corporate fine in the regulatory context would produce overdeterrence—deterrence of desirable conduct.

In addition to individual penalties, the risk of adverse publicity in the event of discovery may help to deter conduct of neutral profitability.

A. Overspill[45]

While as a rule the cash fine successfully reaches the corporation's shareholders, it needlessly penalizes a great many others along the way. This is particularly so if the fine is so large—as it often must be to nullify expected gain—that it significantly affects the firm's balance sheet. A fine that forces an austerity program may result in employee layoffs.[46] Creditors will feel effects from a penalty if financial instability reduces the value of the obligations they hold. Suppliers, customers, and society as a whole may suffer if financial dislocation causes a temporary idling of productive capacity.[47] The firm itself may be compromised in its ability to bring itself into compliance with the law.[48] Finally, the penalty harms shareholders who purchased their shares after the perpetration of the criminal conduct.[49] These side-effects may collectively be referred to as overspill. Though present in criminal sanctions of every type,[50] overspill is undesirable, and in the context of corporate punishment it is the central obstacle to a system of rational and effective fines.

It is possible to ameliorate overspill somewhat by collecting a fine in a series of installments. This approach lessens the probability of a liquidity crisis. Installment fines are an option available today to many courts,[51] and a few corporate sentences have taken this form.[52]

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45. The term comes from Coffee, *supra* note 10, at 387 n.4.

46. *Id.* at 401-02 & n.50.

47. *See* State v. Lawn King, Inc., 152 N.J. Super. 333, 343, 377 A.2d 1214, 1219 (1977), *rev'd on other grounds*, 169 N.J. Super. 346, 404 A.2d 1215 (1979), *aff'd*, 84 N.J. 179, 417 A.2d 1025 (1980).

48. *See, e.g.*, United States v. J.B. Kramer Grocery Co., 294 F. Supp. 65, 66 n.2 (E.D. Ark.) ("[A] large fine [for violation of the Food, Drug and Cosmetic Act] would inhibit any efforts to improve the physical condition of the business premises and in the long run would tend to defeat the purpose of the Act."), *aff'd*, 418 F.2d 987 (8th Cir. 1969).

49. On the New York Exchange, for example, stock ownership turued over at an average rate of 28% per year from 1973 through 1982. *See* NEW YORK STOCK EXCHANGE, 1983 FACT BOOK 68 (1983).

While there is no valid objection to placing the burden of corporate fines on the shareholder class, an ideal system would often define that class at the time of the misdeed rather than a number of months or years later. Where shareholders are all quite innocent of the doings of their firms, this lag time is of little consequence, for the risk of a criminal fine—taking lag time into account—would be reflected in the buying and selling price of all shares. Any rehabilitative effect of a fine, moreover, is strengthened by imposing the penalty on those currently tied to the corporation. The difficulty arises where selling shareholders are negligently or willfully responsible for criminal conduct, or where they have secret knowledge that such conduct has taken place. For further discussion of this issue, see *infra* notes 106-08 and accompanying text.

50. *See, e.g.*, N. WALKER, SENTENCING IN A RATIONAL SOCIETY 18-19 (1969). The imprisonment of a bank robber, for example, can have a deplorable effeet on his innocent family.

51. *See, e.g.*, CAL. PENAL CODE § 1205 (West 1982); MICH. COMP. LAWS ANN. § 769.3 (West Supp. 1983); OR. REV. STAT. § 161.675 (1983); *see also* STANDARDS FOR CRIMINAL JUSTICE § 18-2.7(b) (2d ed. 1982).

52. *See, e.g.*, United States v. American Bag & Paper Corp., 609 F.2d 1066, 1067 (3d Cir. 1979) ($500,000 fine payable in 10 annual installments).

The practical effect of this expedient on overspill is limited, however. A large fine so imposed could lead to a chronic cash shortage, while so reducing the prospect for future profit that there would be little incentive to save the firm. At the same time, the fixed cost of the fine payments would put the company at a long-term competitive disadvantage. The true penalty effect of such a fine is its present value, moreover, and to obtain a high present value it ordinarily would be necessary to make substantial collections in early years. The potential for spreading impact across a long period would therefore be limited. Overspill thus remains a serious concern in any large cash fine.

B. Judicial and Prosecutorial Nullification

An apparent corollary to overspill is the hesitancy of prosecutors to recommend, and judges to impose, cash fines large enough to neutralize the profit motive of corporate crime. It is difficult to find unambiguous examples of such nullification in the case law, in part because sentencing determinations, where reported, are often accompanied by little or no factual detail. Where they have noted a possibility of serious overspill, however, courts and prosecutors have been inclined to adjust penalties to mitigate the threat.[53] The Environmental Protection Agency, for example, is now armed with a statute authorizing enormous fines in some cases, yet some violators apparently have been able to rely on and exploit the agency's reluctance to call for ruinous penalties.[54]

In the antitrust context—admittedly an area complicated by the concurrent availability of private treble-damage actions[55]—the cases reveal a pattern that has struck some commentators as systematic nullification.[56] The celebrated Heavy Electrical Equipment antitrust prosecu-

53. *See, e.g.*, Roginsky v. Richardson-Merrell, Inc., 378 F.2d 832, 841 (2d Cir. 1967) (public and stockholders to suffer from excessive punitive damages); United States v. Danilow Pastry Co., 563 F. Supp. 1159, 1166-67 & n.14 (S.D.N.Y. 1983); *cf. supra* note 41.

Fear of overspill presumably could also affect legislative willingness to set high maximum fines. Legislatures, however, provide for fines in the abstract. A penalty that could provoke an angry backlash in actual application might be applauded for its toughness on crime when enacted. Indeed, statutes increasingly permit large fines for corporations, particularly where multiple convictions may be sought. *See supra* note 41. Courts, however, have lagged in applying these higher maxima. *Compare, e.g.*, N.Y. PENAL LAW § 80.10 (McKinney Supp. 1984) *with* People v. Mature Enters., Inc., 73 Misc. 2d 773, 343 N.Y.S.2d 934 (Crim. Ct. 1973), *aff'd*, 76 Misc. 2d 660, 352 N.Y.S.2d 346 (Sup. Ct.), *modified*, 35 N.Y.2d 520, 323 N.E.2d 704, 364 N.Y.S.2d 170 (1974). *See also, e.g.*, 2 J. CLABAULT & M. BLOCK, SHERMAN ACT INDICTMENTS 1955-1980, at 703 (1981).

54. *See* 42 U.S.C. § 7413 (1982); Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 882-83 n.74 (1984). This example arguably borrows from the regulatory sphere, *see supra* text accompanying notes 5-9, but does so in an area where expected harm—the touchstone for determining optimum fines in that sphere—could be very large.

55. *See supra* note 41.

56. *E.g.*, Coffee, *supra* note 10, at 406. *See generally* J. CLABAULT & M. BLOCK, *supra* note 53; Posner, *A Statistical Study of Antitrust Enforcement*, 13 J.L. & ECON. 365 (1970).

tion, for example, involved "the most serious violations of the anti-trust laws since the time of their passage."[57] It covered seven billion dollars in fixed prices and rigged bids,[58] yet the fines imposed on the 29 corporate defendants averaged less than one-third of the statutory maximum. General Electric, the largest of the offenders, received a fine of just over half the maximum, amounting to but 0.3% of its yearly profit.[59] The history of small fines in the antitrust field may stem not so much from fear of overspill—hardly a serious consideration in the above example—as from other considerations such as a disinclination to impose penalties that fall on innocent stockholders.[60] But elimination of overspill would remove one roadblock to effective penalties.

If the above considerations do not deter a judge or prosecutor, political pressures might stay his hand. A case described by Professor Reich demonstrates the potential for strong public reaction when a prosecution threatens substantial overspill in a community. The FTC's 1972 antitrust suit against cereal makers provoked unanimous denunciation by the Michigan legislature. The City of Battle Creek went so far as to countersue, demanding that the Commission issue an environmental impact statement regarding the case.[61]

C. *The Wealth Boundary*[62]

Because some corporate criminal activity may be lucrative, and the rate of apprehension for such conduct low,[63] the fine required to deter a profit-maximizing corporation can be very large. But the corporation's pocket is only so deep; limited liability allows no recourse if the firm's assets will not cover the fine.[64] Thus, the management of a million-dollar corporation might choose to procure by bribery a contract that will net the firm $200,000 in profit while incurring a risk of apprehension of ten percent, regardless of the fine attached to the crime. The firm's shareholders, if their investments are diversified, will prefer a sure $200,000

57. Application of California to Inspect Grand Jury Subpoenas, 195 F. Supp. 37, 39 (E.D. Pa. 1961).

58. Note, *supra* note 28, at 287.

59. K. ELZINGA & W. BREIT, *supra* note 41, at 56; Note, *supra* note 28, at 287.

60. In other contexts, courts have sometimes been reluctant to penalize innocent shareholders, even where the shareholders have been enriched by illicit corporate acts. *See, e.g.*, Roginsky v. Richardson-Merrell, Inc., 378 F.2d 832, 841 (2d Cir. 1967).

61. Reich, *The Antitrust Industry*, 68 GEO. L.J. 1053, 1062-63 n.34 (1980).

62. The phrase is taken from Coffee, *supra* note 10, at 390 n.13. Coffee more commonly refers to this phenomenon as the "deterrence trap." *Id.* at 390 n.15.

63. *Id.* at 390-91.

64. If a corporation's initial capitalization is grossly out of proportion to risks its investors could easily foresee, the doctrine of "piercing the corporate veil" may come into play. But merely to risk liability well beyond capitalization will not implicate the doctrine. *See generally* Hackney & Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837, 891-99 (1982).

gain to a ten percent risk of a $1,000,000 loss.[65]

The problem posed by the wealth boundary is often more theoretical than real. Those who have trumpeted its dangers[66] overlook the availability in many cases of individual penalties to supplement deterrence. In all but the smallest corporations, moreover, bankruptcy often has built-in disincentives for management, such as loss of employment, reputation, or prestige, that likewise fall outside the calculus of monetary risk and expected gain.

Yet even where individual penalties or personal considerations of management add to the balance of deterrence, the wealth boundary leaves shareholder interests at odds with society's goal. Managers may feel pressure to serve the shareholders. Indeed, there are occasional reminders that the wealth boundary problem is not wholly illusory. In the Kepone prosecution of Allied Chemical, for example, one defendant was LSP, Inc., an entity set up to conduct the risky Kepone manufacture for Allied's benefit. LSP seemingly was provided with minimal capital in what may well have been an effort to limit the downside risk of lawbreaking. The firm's thirty-two dollars in assets proved inadequate to satisfy the $3.8 million fine levied against it.[67]

D. Shareholder and Management Indifference

Shareholders of a publicly held corporation are apt to be remote from an event such as the imposition of a fine. If they notice it at all, they may not perceive it as a direct loss to themselves. In any event, a fine may seem no more than bad luck or a cost of doing business. Of course, a fine that seriously hobbles the corporation will make a strong impression and, presumably, provoke more careful thought as to its cause. But fines of that size are not typical.

The impact of a cash fine must pass twice through the synapse between corporation and shareholder before it can affect policy. The first

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65. Levying a fine in installments does not affect the wealth boundary. For an ordinary cash fine, the maximum loss to the shareholders if the fine forces bankruptcy is the value of their investment. Because market value ordinarily exceeds liquidation value, the court cannot collect the full amount of that loss, but the penalty effect is nonetheless real. The maximum penalty effect of an installment fine is the same. If the present value of the fine exceeded the present value of the future earnings of the corporation—its market value—the firm would not be financially viable. In each case, then, stockholders can forfeit a value up to, but not exceeding, the market value of their shares. While an installment fine enables the court to *collect* a larger percentage of this maximum forfeiture, it does not alter the maximum shareholder exposure to penalty effect. *Cf. infra* text accompanying notes 91-93 & Figure 1.

66. *See* Coffee, *supra* note 10, at 389-93; Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L.J. 1, 68 (1980).

67. *See* Goldfarb, *Kepone: A Case Study*, 8 ENVTL. L. 645 (1977); *Allied Chemical Gets Kepone Fine of $13.3 Million*, Wall St. J., Oct. 6, 1976, at 2, col. 2; *cf.* United States v. Danilow Pastry Co., 563 F. Supp. 1159, 1166 (S.D.N.Y. 1983) ("[F]ines substantial enough to achieve the appropriate measure of deterrence would bankrupt the corporate defendants.").

crossing is from corporation to shareholder. A variety of circumstances may make shareholders indifferent to the penalty. They may not realize (in an accounting sense) the loss occasioned by the fine for some time, or the realization of that loss may be masked by other financial developments. Furthermore, their investment stake per person is likely to be relatively small. They may rightly or wrongly view the illegality as serving their own interests. Finally, they may know they would have difficulty in forcing change on management, even if they were so inclined.

The second crossing is from shareholder to corporation. Even when shareholders are not indifferent, the fine will have limited effect on firm policy unless its effect passes again across the synapse and back to the corporation: the stockholders must express their discontent in some way that touches management.

This second crossing of the synapse is the usual focus of critics of corporate fines.[68] In fact, the second crossing is the easier one. While it is unlikely that aggrieved shareholders in a publicly held concern will take a direct role in changing the behavior or composition of management, unhappy shareholders are likely to sell their shares. The resulting downward pressure on stock prices undoubtedly influences management.[69] It is more difficult to impress on shareholders that they have been aggrieved to begin with. If they do not have that perception, much of the potential deterrent value of a fine is lost. General deterrence suffers because managers contemplating illegal conduct need not fear the dangers of a disgruntled shareholder population. Specific deterrence declines because following a conviction the stockholders will exert no direct or indirect pressure for internal reform. And shareholder indifference to a fine encourages management indifference.

Shareholder apathy does not render a fine useless. The fine continues to eliminate unjust enrichment and neutralize the profit motive for criminal activity. It also may exert a deterrent force by affecting the value of management stockholdings and stock options, by personally embarrassing management through adverse publicity, and by placing a financial drag on management's ambitions for the firm.[70] Nonetheless, if

68. *See, e.g.*, C. STONE, *supra* note 12, at 47-48; Coffee, *Corporate Crime and Punishment: A Non-Chicago View of the Economics of Criminal Sanctions*, 17 AM. CRIM. L. REV. 419, 460 (1980); Comment, *supra* note 40, at 920.

69. *See* Lewellen & Huntsman, *supra* note 34, at 710 (effect on compensation); Manne, *The "Higher Criticism" of the Modern Corporation*, 62 COLUM. L. REV. 399, 410-11 (1962) (vulnerability to takeovers); Werner, *Management, Stock Market and Corporate Reform: Berle and Means Reconsidered*, 77 COLUM. L. REV. 388, 402-05 (1977) (effect on management stock options and on availability of financing for expansion).

70. If all else fails, sufficiently large fines conceivably could force from the marketplace firms that ignore legal restrictions. *Cf.* Vaughan, *Toward Understanding Unlawful Organizational Behavior*, 80 MICH. L. REV. 1377, 1379-80 (1982). In most cases this process of corporate Darwinism would be far too slow and submerged by far too many other variables to be of much benefit as a

stockholders can be made more acutely aware of fines, the penalties will serve in additional deterrent and rehabilitative roles.

III
EQUITY FINES

Professor Coffee has recently proposed a new mechanism for fining corporations that circumvents some of the undesirable features of cash fines. Through what he has called the equity fine,[71] Coffee would have the court impose a fine, not in the form of a cash payment from the corporate entity, but rather by requiring the firm to issue common shares to the state. He would allocate these shares to the state's crime victim compensation fund, which in turn would dispose of them on the open market.[72] The number of shares issued would be the number required to reduce the aggregate market value of the holdings of current shareholders by an amount equal to the optimal fine.[73] In determining market value for the purposes of this calculation, the court would compensate for any distortions in current market value occasioned by the expectation that the court would impose a fine.[74] Coffee claims a broad range of

means of control. If fines were large enough to make such a process rapid, overspill problems would multiply.

71. *See* Coffee, *supra* note 10, at 413. Professors Brent Fisse and Michael Metzger have published short critiques of the equity fine founded on views of the purpose and operation of corporate fines quite different from the one presented *supra* in Part I. *See* Fisse, *supra* note 40, at 1235-37; Metzger, *Corporate Criminal Liability for Defective Products: Policies, Problems, and Prospects*, 73 GEO. L.J. 1, 69-70 (1984).

72. Coffee, *supra* note 10, at 413 & n.78.

The United States Constitution provides an adequate framework for enactment of an alternative fining scheme such as Coffee's. Not only could any state amend corporate charters retroactively so as to alter corporate obligations, *see* MODEL BUSINESS CORP. ACT ANN. § 149, at comment, ¶ 2 (2d ed. 1971), but, most significantly, a state could enforce altered liability rules against out-of-state corporations as a condition of doing business in the state. *See, e.g.*, Thomas v. Matthiessen, 232 U.S. 221, 234 (1914); Provident Gold Mining Co. v. Haynes, 173 Cal. 44, 46-47, 159 P. 155, 157 (1916).

73. This sentence reformulates the calculation Coffee proposes. He refers to the issuance of shares having a "pre-indictment value" equal to the penalty. Coffee, *supra* note 10, at 413 n.78. But imagine a corporation having 10 shares outstanding with a pre-indictment market value of $50 each. The court wishes to impose a fine of $250. It is insufficient to require the corporation to issue just five shares to the state, even though such an issue, had the corporation sold it for cash, might have commanded $250 on the pre-indictment market. In order to reduce the value of the existing shareholders' equity by $250, the court must direct the issuance of 10 shares. This is because each share given away without benefit to the corporate treasury is worth less than the last. Elsewhere, Coffee demonstrates that he appreciates this complication. *See id.* at 414 (example in text accompanying n.81).

A complex equity and debt structure can introduce further complications to the mechanism of an equity fine. *See infra* Part V.

74. Again, the text departs slightly from the formulation in Coffee's article. *See* Coffee, *supra* note 10, at 414-15 n.81 (mentioning only a need to use pre-indictment values to rectify distortions resulting from prosecution). While a reference to pre-indictment market values might provide a simple way of eliminating such distortions in some cases, it is likely that business considerations unrelated to the criminal activity would also affect market values where the date of the indictment

advantages for the equity fine that demand scrutiny.

A. Reduced Overspill

As Coffee observes, the equity fine eliminates damage to the corporate entity itself and therefore practically eliminates overspill to such groups as suppliers, creditors, and employees.[75] Harm to society at large likewise recedes, for no crisis of solvency will interrupt production or threaten to eliminate capital needed to bring the firm into compliance with the law. Apart from the shareholders, only optionholders are likely to be affected.[76] The equity fine presents a phenomenon rare in the world of sentencing: a penalty with precisely directed and easily quantifiable economic effects.

B. Reduced Nullification

Coffee seems to maintain that equity fines ought to make prosecutors and judges less averse to large penalties.[77] He advances five arguments to support his view that the equity fine would seem fairer to those responsible for sentencing. These relate, respectively, to superior loss spreading, passing on loss to management, passing on benefits to victims, assumption of risk, and lessened overspill. All but the last are misleading.

Coffee asserts that the equity fine improves loss spreading by distributing the burden of a fine evenly across the class of shareholders.[78] In fact, it offers no such benefit. Owing to reduced overspill, the total loss occasioned by an equity fine is smaller than the loss resulting from a cash fine of the same magnitude. Nevertheless, the shareholders continue to bear the burden of the penalty to the same extent and in the same proportions as they would a cash fine. And for a stockholder whose holdings are substantial, the loss might be severe.

Coffee next contends that shareholders can pass on an equity fine's loss to responsible officials by means of derivative suits.[79] Yet the same avenue is open (with the same practical limitations[80]) to the stockholder

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and the date of sentencing are widely separated. To screen out the effect on market value of such unrelated post-indictment business developments would risk imposing a penalty on the shareholders substantially greater or smaller than the optimum. *Cf.* 2 J. CLABAULT & M. BLOCK, *supra* note 53, at 722-23 (average antitrust prosecution requires about seven months to complete).

75. Coffee, *supra* note 10, at 413-16.

76. The merits of penalizing this group are discussed *infra* in notes 100, 105 and accompanying text.

77. *See* Coffee, *supra* note 10, at 414-17.

78. *Id.*

79. *Id.* at 417.

80. *See, e.g.*, Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96 (1980).

victims of a cash penalty; it gives the equity fine no special claim on fairness. Moreover, the suggestion of a derivative suit raises the troubling possibility of a corporation indemnifying one of its officers or employees for liability to shareholders occasioned by an equity fine.[81] Such a maneuver would effectively convert the equity fine back into a cash fine. Even if indemnification could be prevented, successful derivative suits would, as a practical matter, often reimburse shareholders only to the extent of the defendants' insurance. Where the wrongdoing occasioning the fine was intentional, such insurance would generally be unavailable.[82]

Third, Coffee suggests that the proceeds of equity fines could be channeled into a compensation fund for victims of all types of crime.[83] This argument likewise fails to bolster his claim that the equity fine will seem fairer to judges and prosecutors. Even if such a program could counter nullification, it is separable from the equity fine. One could just as easily devote the proceeds of conventional fines to such a fund. In any event, actual sentencing experience argues against putting the proceeds of fines to such use. The cases suggest that channeling penalty funds to a worthy cause can in fact move a court to lessen penalties, perhaps on the view that by doing good the defendant negates some of its need for punishment. In one mail fraud and bid-rigging prosecution, for example, the trial judge suspended fines totaling $554,000 on the condition that the corporate defendants make available a quarter of that amount for programs to fight crime.[84] Similarly, in a price-fixing case corporate contributions of as little as $1000 to an alcoholism treatment program substituted for fines of $50,000.[85]

The shareholders, Coffee next argues, may be viewed as having

81. *See generally* DEL. CODE. ANN. tit. 8, § 145(b) (1974) (permitting such indemnification with court approval); MODEL BUSINESS CORP. ACT § 5(b) (rev. ed. 1979) (same).

82. *See, e.g.*, Bishop, *New Problems in Indemnifying and Insuring Directors: Protection Against Liability Under the Federal Securities Laws*, 1972 DUKE L.J. 1153, 1160. While courts have allowed insurance policies to cover intentional acts violating difficult-to-interpret regulatory statutes, a policy covering violations of absolute prohibitions against such plainly illegal conduct as bribery or fraud would be void as against public policy. *See, e.g.*, Solo Cup Co. v. Federal Ins. Co., 619 F.2d 1178, 1187 (7th Cir.), *cert. denied*, 449 U.S. 1033 (1980); Hartford Life Ins. Co. v. Title Guar. Co., 520 F.2d 1170, 1175 (D.C. Cir. 1975).

83. Coffee, *supra* note 10, at 416.

84. United States v. Prescon Corp., 695 F.2d 1236, 1238 (10th Cir. 1982) (reproducing portion of trial record).

85. United States v. Clovis Retail Liquor Dealers Trade Ass'n, 540 F.2d 1389, 1389-90 & n.2 (10th Cir. 1976) (describing trial court's sentencing and remanding on defendants' objections); *see also* United States v. Wright Contracting Co., 563 F. Supp. 213, 214 (D. Md. 1983) (total penalty reduced by $175,000 in package including "corporate penance" payments to charity), *vacated*, 728 F.2d 648 (4th Cir. 1984); Stone, *A Slap on the Wrist for the Kepone Mob*, BUS. & SOC'Y REV., Summer 1977, at 4, 8 (Allied Chemical's effective penalty reduced by $4 million through court-approved substitution of charitable contributions for fine). Coffee does not advocate that the proceeds of an equity fine go to the private victims of the particular conduct occasioning the pen-

"assumed the risk" of equity fines at the time of investment.[86] This does not render such penalties fairer than cash fines. Stockholders likewise assume the risk of a cash fine.

Only the reduced overspill hypothesis remains to support Coffee's argument that equity fines would lessen nullification. There is indeed reason to hope that by mooting some of the arguments for leniency in corporate sentencing the equity fine could improve the likelihood of effective fines. An equity fine, however, obliges judges and prosecutors to confront more squarely the fact that fines fall not merely on the faceless corporation but also on its shareholders, a group often simplistically classified as "innocent."[87] Of course, an equity fine in fact does the stockholders no more harm, dollar for dollar, than a cash fine. On balance courts and prosecutors, properly educated, might ultimately be more comfortable with heavy fines levied on equity than with equivalent fines levied on assets. But equity fines alone cannot be expected to effect a dramatic increase in the imposition of large corporate fines.

C. The Claim that Equity Fines Pierce the Wealth Boundary

Coffee observes that the size of a cash fine is effectively limited to a corporation's liquidation value, whereas an equity fine taps into market value—that is, into the present value of the company's future earnings.[88] Because market value often greatly exceeds liquidation value, he asserts that the equity fine largely "outflanks" the wealth boundary barrier to effective deterrence.[89] For an example, he points to the young company with few assets but bright prospects, the sort of venture capital firm whose shares command a price far in excess of liquidation value. Coffee reasons that because a fine on the equity of such a corporation can be much larger than a cash fine, the firm will have far more to lose from criminal activity and therefore will be less willing to risk criminal conduct.[90]

But Coffee confuses the value that the state realizes from a fine with the value lost by those paying the fine. It is true that the state can ordinarily realize no more from a cash fine than the liquidation value of a firm,[91] whereas the stock acquired by means of an equity fine could often be sold for a larger sum. The loss to the shareholders, however, is no less

alty. For many serious crimes, no such victims are identifiable; where they are, a fine set at the deterrence optimnm would often greatly exceed their damages.

86. Coffee, *supra* note 10, at 417.

87. *See supra* note 40.

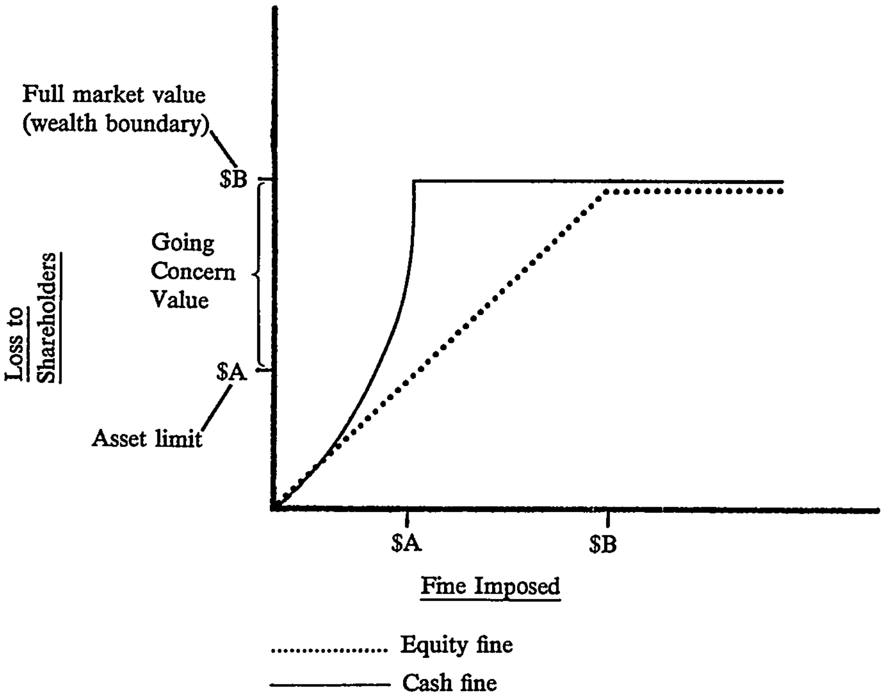
88. Coffee, *supra* note 10, at 419-20.

89. *Id.* at 420.

90. *Id.* at 419-20.

91. Levying a cash fine in installments would make it possible to collect fines somewhat exceeding this limit.

Figure 1



in the former case. When a cash fine bankrupts a corporation, the shareholders lose not merely its liquidation value, but its full market value. The equity fine does nothing to increase their exposure or to alter the calculus of deterrence.

The true function of the equity fine in relation to the wealth boundary is twofold. First, it permits fines to approach the boundary without undue overspill. Second, it allows more precise calibration of fines that approach the boundary. Figure 1 traces the operation of large cash and equity fines as they increase in size.[92] As a cash fine approaches the limit of a corporation's assets and begins to threaten solvency, the loss in market value to the shareholders begins to exceed substantially the dollar value of the fine, due to the increasing threat to the going concern value of the firm. The degree of divergence between cash loss and market value loss may be quite difficult for a court to forecast, except that a fine in excess of the firm's capacity to raise cash will impose a loss equal to the market value of the corporation, regardless of whether that value is

92. For the sake of simplicity, this model ignores the effect of spreading collection across a series of installments. Because installment fines would affect liquidity to a degree, their penalty effect would rise in a curve similar to that of ordinary cash fines, but with a lower slope.

greater than or smaller than the fine. Figure 1 plots a likely path of the divergence, but the precise shape of the curve would probably be highly idiosyncratic and perhaps unknowable.

An equity fine behaves quite differently. Because there is no threat to solvency, the loss imposed on the shareholders falls into a simple linear relationship with the value of the shares exacted from the corporation, and the loss ought to be substantially more predictable.[93] There is one caveat to relying upon this linear relationship. The aggregate penalty effect may fall somewhat above the diagonal line at the point at which the addition of a new bloc of shares causes any controlling shareholder or group of shareholders to lose control of the enterprise. This is because the loss of control causes a lump-sum forfeiture of whatever value these shares have *as a bloc* by virtue of that control, in addition to generalized investment value. In a corporation with dispersed ownership, of course, there is no control value to be lost. For these management controlled firms, nothing substantially distorts the one-to-one linear relationship between the dollar value of the equity fine and the aggregate loss to the shareholder body.

D. Reduced Shareholder and Management Indifference

1. Shareholder Indifference

As explained previously, where fines are less than catastrophic in size, much potential to coerce lawful conduct may be lost due to the inattentiveness of shareholders.[94] If the shareholders do not notice or care about a penalty, there is little point in speculating about their ability collectively to influence management. Coffee believes that the equity fine will rouse the slumbering shareholders to exert such influence.[95]

The mere expedient of shifting the target of the fine from assets to equity surely will not improve shareholder awareness of fines. A typical stockholder who would not take notice of a change occasioned by a fine in the assets portion of a financial statement would hardly be jolted by an equivalent change to the "shares issued and outstanding" line of the same statement. A change in share values would likewise be of no greater moment to stockholders if brought about by an equity fine than if caused by a cash fine. It is not the mechanism of the equity fine that might awaken the shareholders. Rather, it is the larger fines that could result from the lessened overspill of an equity fining system. While larger

93. The model ignores the possibility that a large fine, by frightening new investors, would reduce the market value of existing holdings by more than the amount of the fine. It is appropriate to screen out this factor because any such effect is properly viewed as a consequence of improved information regarding future risk, rather than as part of the penalty for past crime.

94. *See supra* text accompanying notes 68-70.

95. Coffee, *supra* note 10, at 414, 418-19.

fines of any kind would help to counteract indifference, such fines are more likely to materialize if courts are permitted to levy them on equity.

Quite apart from its role in encouraging larger penalties, however, for the holder of a large bloc of shares an equity fine might indeed be of substantially more concern than an equivalent cash fine. Even a small equity fine could in some circumstances significantly alter the balance of control within an enterprise. To illustrate, suppose a corporation has two shareholders, one holding fifty-one percent of common stock and the other forty-nine percent. Neither shareholder might be concerned by a cash fine of one percent of the market value of the enterprise. But an equivalent equity fine, by breaking the larger shareholder's monopoly on control, would surely attract their notice.

2. *Management Indifference*

The equity fine offers an avenue for reaching management that does not rely on shareholder intermediaries. Coffee points out that the bloc of shares created by a substantial equity fine could become a tempting foothold for a corporate raider. Noting that management now often takes precautions against takeovers, he theorizes that the threat of equity fines would make crime avoidance an antitakeover precaution.[96]

Viewed prospectively, however, the chain of causation between illegal activity and a later takeover would frequently be too tenuous to play a significant deterrent role. The multiple uncertainties that the crime would be detected, that it would bring a large fine, that the fine would attract corporate suitors, and that one of those suitors would succeed[97] could make the risk of takeover too imponderable to figure in a manager's calculus.

But Coffee focuses too narrowly on general deterrence. The greatest benefits may lie in the rehabilitative or special deterrent role changed ownership could serve, reducing the prospect for future misconduct by the same firm. By injecting new blood into the ownership of offending corporations, the equity fine would dilute the interest of existing shareholders and loosen their grip on control. Even if these new owners made no move to expand their control, they would provide a new constituency for directors, one presumably acutely aware of the consequences of the criminal conduct that caused their shares to be issued.[98] For the large portion of American industry that is management controlled—with no

96. *Id.* at 418.

97. Coffee himself has noted the difficulty of accomplishing a hostile takeover in his article *Corporate Crime and Punishment: A Non-Chicago View of the Economics of Criminal Sanctions*, *supra* note 68, at 461 & n.143.

98. In corporations of modest size, existing stockholders would be likely puchasers of newly issued sbares. In that event, the equity fine would resemble a pass-through fine, discussed *infra* in Part IV, Section A.

bloc of shares large enough to provide a ready rallying point for shareholder revolt—an equity fine might produce blocs large enough to make the threat of such a revolt credible. Hence while the equity fine might aid only marginally in the deterrence of corporate crime in the first instance, it would serve more significantly to reduce the likelihood of repeat violations.

Coffee avers that the equity fine opens a second new avenue for reaching management. The dilution of stockholdings and the resulting decline in share values occasioned by a large equity fine would reduce or destroy the value of the stock options commonly held by the managers of large corporations. This effect on options, he argues, serves to align management interests with those of the stockholders.[99] The simplest response to this claim is that an equity fine will affect the value of stock options no more than will a cash fine of the same amount. To the contrary, by threatening solvency a cash fine might actually have a greater impact on share and option values. Hence there is nothing in the equity fine's mechanism that provides new leverage through stock options for controlling corporate conduct. More fundamentally, if it is worthwhile to penalize management as a group for a corporation's crimes, without regard to individual culpability, a system of strict and vicarious liability for all managers of a convicted firm would accomplish the same end without discriminating arbitrarily between managers who hold options and those who do not.[100]

The equity fine's elimination of an impact on liquidity likewise bears on the question of management indifference. A cash fine that is relatively small in relation to a corporation's assets may nonetheless be a considerable annoyance to management. A fine of just one or two percent of assets, for example, might deplete ready cash sufficiently to inconvenience day-to-day operations for a time. A comparable equity fine, on the other hand, would cause no such inconvenience. At the same time, it

99. Coffee, *supra* note 10, at 413-14, 417-18.

100. For examples of similar management liability, see United States v. Park, 421 U.S. 658 (1975); United States v. Shapiro, 491 F.2d 335 (6th Cir. 1974).

Optionholders are the only group other than shareholders that the equity fine targets directly. Even apart from the employee optionholders discussed in the text, the desirability of preserving this group as a target for corporate fines is unclear. It is true that the holders of call options benefit from corporate crime to the extent that crime contributes to raising the value of shares to the strike price. There is no injustice in balancing their risk equation by levying fines, whether in cash or equity, that deprive them of this windfall. But while it is not unfair, the penalization of optionholders in their role as such yields no benefits from the standpoint of crime prevention. Management owes optionholders no duty of loyalty. And unlike shareholders, optionholders do not by virtue of their status hold any power of control over a corporation. Indeed, if a fine greatly reduces stock values it is unlikely that they will ever become stockholders and acquire such power. Penalizing them can therefore serve general and specific deterrent goals only in connection with an overlap of membership between optionholders and a group better able to influence policy.

For further exploration of the relationship between fines and options, see *infra* note 105.

could not be expected to prompt a shareholder revolt, nor would it ordinarily effect a significant change in the makeup of the shareholder body. Indeed, for fines of modest size, Coffee's proposal creates a new problem analogous to the wealth boundary, providing a screen to managers rather than shareholders. Managers could engage in criminal activity with the assurance that in the event of discovery only the shareholders, not the firm, would be affected. This possibility suggests that small penalties threatening only modest overspill might best be levied in cash rather than equity.

In summary, the equity fine offers a single fundamental advantage over cash fines: it eliminates overspill at a stroke. It thus improves fairness and it may encourage heavier fines that would strengthen deterrence. Two subsidiary benefits are the equity fine's alteration of the ownership structure of convicted corporations, which would work in favor of rehabilitation, and the greater predictability of its financial impact on stockholders. On the other hand, the equity fine may be a poor vehicle for a small penalty, where the more direct impact of a cash fine on management would likely outweigh the overspill and ownership advantages of the equity fine.

IV
Pro Rata Shareholder Liability

Cash and equity fines penalize shareholders by diminishing the value of stock. This Part explores penalties that likewise deprive stockholders of value in proportion to their holdings, but that take that value from assets other than stock. First, the pass-through fine, a new alternative to cash and equity penalties, further refines the focus and improves the effectiveness of corporate fines. Second, a device called superadded liability modifies the rules of limited liability. Appended to any of the varieties of fines discussed in this Comment, superadded liability would enhance deterrence without compromising fairness.

A. Pass-Through Fines

The assets and equity of a corporation are not the only targets available for corporate fines. It is possible to bypass the corporate entity altogether, assessing each shareholder a pro rata portion of fines arising from the firm's criminal conduct.

This penalty, which will be referred to as the pass-through fine, renders each shareholder civilly strictly liable for a fixed pro rata share of a criminal fine,[101] the share to be calculated without regard to treasury stock and without regard to payment or nonpayment by other sharehold-

101. The judgment against the corporation could be civil; this Comment uses the term "crimi-

ers. Liability is limited to the market value of the shareholder's holdings. The corporation remains the entity convicted; the penalty is simply disembodied from the conviction. The fine thus reaches the shareholders directly, rather than through the vehicle of the corporation. Shareholders could, of course, sell part or all of their holdings to raise funds to pay the fine, and indeed the state would itself conduct such a sale were a shareholder to fail to meet the obligation. In that event, the effect on the stockholder would be rather like that of a cash or equity fine, for the value of his holding would fall; the only distinction would be that the investor would own fewer shares rather than the same number of less valuable shares. But stockholders could also pay with assets unconnected with the corporation. The pass-through fine is fundamentally a levy on the general assets of stockholders, and unlike cash and equity fines it leaves the per-share value of an investor's holdings untouched.[102]

Though initially a somewhat startling notion, the pass-through approach better achieves the underlying function of corporate fines. The corporation, after all, is but a legal fiction, and monetary punishments applied to it are fundamentally aimed at the stockholders.[103] Pass-through fines would not, in themselves, add to the burden imposed on this group. And if the central goal of corporate fines is to eliminate the profit motive for corporate criminality by preventing stockholder gain, it is not ineluctable that their end be achieved through a corporate instrumentality such as the firm's assets or equity.

The pass-through fine shares the equity fine's fundamental advantage over cash fines: it essentially eliminates overspill. The corporation remains in business, with no loss of jobs or production and no financial hobbling of an otherwise competitive entity. Indeed, the pass-through fine is even more narrowly focused than the equity fine; since the pass-through fine does not affect share prices[104] it does not punish optionholders.[105] Like the equity fine, moreover, the pass-through fine

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nal" to refer to a type of conduct rather than to a type of judgment. *See supra* notes 5-9 and accompanying text.

102. The constitutionality of the civil obligations imposed by pass-through fines is unquestionable. Shareholders would suffer no more penalization than they currently do under the regime of cash fines. In the 1940's, moreover, the Supreme Court found no fault with a more onerous variety of pro rata direct shareholder liability for corporate obligations. *See* Anderson v. Abbott, 321 U.S. 349, 365-66 (1944) (permitting superadded liability). Constitutional issues relating to enforcement are addressed *supra* in note 72.

103. *See supra* text accompanying notes 23-28.

104. *See infra* text following note 109.

105. While the impact of cash and equity fines on optionholders is not unfair, *see supra* note 100, neither is it unfair to focus penalization exclusively on shareholders. For example, the buyer of a call option in a pass-through system buys access to the profits of illicit conduct, but is protected from the loss of a fine. Because of this protection from downside risk, shareholders will be able to obtain slightly higher prices for the calls they choose to sell. These higher prices will compensate them for transferring the expected gain component of criminal risk while retaining the negative

leaves a corporation's capital intact.

A second benefit of the pass-through fine potentially enhances both deterrence and fairness. Cash and equity fines fall on current shareholders rather than on those who held shares at the time of the wrongdoing. While this arrangement may serve a rehabilitative purpose, it undermines deterrence. Any shareholder with inside knowledge can reap the benefits of wrongdoing and then sell his shares before the criminal act is discovered.[106] The pass-through fine, in contrast, functions rather like a reverse dividend. The obligation need not fall on current owners of the corporation's shares. The record date—the date as of which shareholders of record will be liable for a portion of the fine—can be set to coincide with the date of the wrongdoing,[107] with the date of the indictment or information, or with some other date chosen to include as many culpable shareholders as possible. This flexibility in the record date is most useful in connection with corporations having relatively few stockholders. In such cases the practical difficulty of tracking down former shareholders is not daunting.[108] And the more direct management role these stockholders ordinarily possess enhances the fairness argument for levying the fine on those holding stock at the time of the misconduct.

Pass-through fines surpass both equity and cash penalties in ease of calibration.[109] Stockholders of a corporation incurring a pass-through fine lose precisely the amount of their assessment. There is no need to evaluate the effect of the fine on solvency, nor does the penalty value of loss of control distort the penalty effect, as it does for equity fines. In some cases, of course, assessments could indirectly depress share prices by alerting the market to any risk of future violations. This additional loss, however, is not truly part of the penalty. Instead, it simply reflects a benign alteration of the information balance in the market regarding future risk. The net penalty effect on shareholders for past corporate conduct is exactly the cash value of the fine.

In the case of publicly held corporations, the greatest advantage of pass-through fines over both cash and equity fines is in combatting shareholder indifference. There can be little doubt that the receipt of a bill in

component—risk of conviction. At the same time, the higher price of calls should counterbalance the unjust enrichment that optionholders might otherwise receive from corporate crime.

106. *See also supra* note 49. Assuming that this chain of events can be demonstrated, the buyer may have a cause of action in fraud against the seller. Such proof might be difficult to assemble, however, and if the seller's bloc of shares is small or has been fragmented in the sale there may be no buyer with a sufficient economic stake to bring suit.

107. Of course, the criminal conduct might have taken place over time. In such cases the appropriate moment for penalization might be difficult to pinpoint.

108. However, a simple expedient such as the entry of social security numbers in the stock ledger could make tracing of former owners—at least those who pay taxes—a relatively simple matter, even in publicly held concerns.

109. *Cf. supra* Figure 1 and accompanying text.

the mail is more likely to gain a shareholder's attention than an equivalent loss in the form of diminished share values. Stockholders thus disgruntled would be more apt to sell shares, either piecemeal—forcing down prices—or to a corporate raider. Moreover, they would be more likely to respond to internal revolt fomented by a major stockholder. Any of these courses of action would threaten management,[110] and managers would be compelled to respect the potential impact of a substantial pass-through fine.

Any system incorporating pass-through fines must address several new issues of practical application. While the transaction costs of imposing cash and equity fines are minimal, pass-through fines entail more significant billing and collection[111] costs. These costs, which would be financed from the proceeds of the billing, might exceed the proceeds of small fines. A pass-through mechanism is therefore unsuitable for penalties amounting to only pennies per share.

The pass-through fine also raises the practical question of how to assess the contributions of shareholders that are themselves corporations. Again, the appropriate solution depends on the size of the liability. The same arguments for passing liability through the offending corporation also apply to the liability received by a shareholding corporation, but the same practical considerations relating to transaction costs likewise apply. Suppose corporation *X*, with one million outstanding shares selling at $100, incurs a fine of $10 million. Corporation *Y*, which has half a million stockholders, owns 5,000 shares of *X* as an investment. It would be foolish to require *Y* to raise its portion of *X*'s fine by billing its own stockholders for an average of ten cents each. But if *Y* owned fifty percent of the stock of *X*, an average billing of $10 per shareholder of *Y* might make sense.

A third practical concern is the risk of indemnification. A corporation might try to mollify shareholders by declaring a dividend to compensate them for their contributions to the fine. Such a maneuver would transform a pass-through fine into a cash fine. Presumably many shareholders would understand, however, that the dividend merely transferred money from one of their pockets to another. In any event, a sentencing court could review the firm's financial statements for a year or two to guard against outsized dividends.

One might object that the prospect of receiving bills in the mail for their corporations' misdeeds would frighten investors and dry up capital markets. Putting aside the possibility of a shift in record date, however, a cash-poor investor would at worst risk being obliged to sell some stock to

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110. *See supra* note 69.

111. Because shares carrying unpaid assessments could be seized for resale by means of a simple entry in the stock ledger, collection costs should be small in most cases.

raise funds to cover the fine. The value of the remainder of the holding would be no smaller than the value of the entire holding in the aftermath of a cash or equity fine. Even if fears chilled capital sources to some degree, the net effect of pass-through fines on capital formation, as compared to cash fines, would likely be positive: unlike cash penalties, pass-through fines do not deplete the capital a corporation has on hand.[112]

Perhaps the most telling argument against pass-through fines stems from nullification. The issue is again one of psychology rather than substance. Since a pass-through fine forces a court to face squarely the fact that a corporate penalty is directed at shareholders, pass-through fines might be emotionally and politically difficult to impose. A pass-through fine leaves the strict and vicarious liability of innocent shareholders unconcealed. Courts, as a result, might be tempted to call for evidence of actual and direct participation in wrongdoing by shareholders before imposing enterprise liability.[113] To minimize the likelihood of nullification, a legislature adopting the pass-through approach should make explicit such purposes as aligning shareholder interests with the law regardless of blame. Courts would be more likely to impose such fines, moreover, if prompted by a legislative finding that pass-through fines are less harmful to innocent parties than are the alternatives.

To sum up, the pass-through fine shares several of the equity fine's advantages, most significantly its elimination of overspill. It lacks the rehabilitative feature of equity fines—changed ownership—and to escape nullification it demands a high level of sophistication from courts. On the other hand, it adds two new dimensions to fines that might make it a highly effective weapon. First, it enables courts to counteract the effects of slow detection and enforcement, making it difficult for shareholders who happen to be culpable to escape penalization by selling out. Second, it provides a means—perhaps the only possible means—of effectively combatting shareholder indifference in publicly held corporations.

B. Superadded Liability

Cash, equity, and pass-through fines all operate within the corporate wealth boundary. The shareholders as a group stand to lose no more than the market value of the firm. Yet no immutable principle requires

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112. Inducing timidity on the part of management likewise does not render the pass-through fine unattractive. While it is not desirable to frighten management into undue caution in areas where it might be socially efficient to skirt the edges of the law, such areas are not the subject of the proposals in this Comment. *See supra* text accompanying notes 5-9.

113. Judges have sometimes been reluctant to embrace strict liability rules without qualification. *See, e.g.*, Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973) (restrictive interpretation of strict civil liability rule in certain securities transactions, where defendant appeared likely to be innocent); *cf.* United States v. United States Gypsum Co., 438 U.S. 422, 436 (1978) (presumption of mens rea requirement in construing criminal statutes).

penalties to stop at that boundary; indeed, the wealth boundary was once far less impenetrable than it is today. A form of pro rata liability analogous to the pass-through approach once prevailed for corporate debts exceeding the capacity of the firm's assets. If restricted to the criminal context and improved with certain mechanical refinements,[114] this device can be adapted to serve as a useful supplement to cash, equity, or pass-through fines.

In the mid-nineteenth century, the California Constitution held "[e]ach stockholder of a corporation . . . individually and personally liable for his proportion of all its . . . liabilities."[115] A similar provision survived until 1930,[116] while in other states as well statutes and constitutional provisions commonly imposed proportional liability running significantly beyond the value of a corporation's assets.[117] These provisions, known as added or superadded liability, have disappeared with the universal and practically unqualified embrace of limited liability.[118] Shareholder liability for corporate fines is now apparently limited to cases of fraudulent undercapitalization, mixing of shareholder and corporate assets, or direct participation in the wrongdoing, and in the last event only through individual criminal prosecution.[119]

Whatever the merits of the limited liability that screens investors from a corporation's debts to its voluntary creditors and even to its tort creditors, a review of the precise contours of superadded liability suggests that in the criminal context it was abandoned too hastily.[120] Superadded liability is pro rata; it is not the joint and several liability that prevails for partnerships. If a corporation is unable to pay a fine levied against it, each shareholder becomes civilly liable for a proportion of the balance commensurate with his or her proportion of the equity of the firm.[121] The proportion remains unaltered regardless of whether the state is able

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114. *See infra* note 121.

115. CAL. CONST. of 1849, art. IV, § 36 (revised 1879).

116. CAL. CONST. of 1879, art. XII, § 3 (repealed 1930).

117. *See* 13A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 6224, 6273 & nn.2-7 (perm. ed. 1984); Ballantine, *Stockholders' Liability in Minnesota*, 7 MINN. L. REV. 79, 81, 97-98 (1923). For a relatively recent example of the application of such liability, see Bates v. Farmers Sav. Bank, 225 Iowa 232, 280 N.W. 487 (1938).

118. *See* 13A W. FLETCHER, *supra* note 117, § 6224. A few remnants of added liability survive in the form of double par liability for bank stock. *Id.* § 6224.1. Stockholders of a close corporation may incur personal liability with regard to wage payments in some states. *E.g.*, N.Y. BUS. CORP. LAW § 630 (McKinney 1963).

119. The text assumes that corporate formalities have been observed and subscriptions paid up. *See generally* Minton v. Cavaney, 56 Cal. 2d 576, 579-80, 364 P.2d 473, 475, 15 Cal. Rptr. 641, 643 (1961); H. HENN & J. ALEXANDER, LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 146 (1983). *See also supra* note 64.

120. For an argument advocating the use of superadded liability for delicts, see Stone, *supra* note 66, at 69, 74-75.

121. The calculation of this proportion should ignore treasury stock. *Contra* 13A W. FLETCHER, *supra* note 117, § 6278 & n.9. If treasury stock were counted for the purpose of calculat-

to collect the contributions of other shareholders,[122] for with respect to each shareholder the optimum penalty for eliminating expected gain from criminal conduct is unaffected by nonpayment by fellow stockholders. If the shareholder of a convicted corporation is itself a corporation, the shareholders of the shareholder corporation may be held liable to the extent that the intermediate corporation fails to meet its proportional obligation.[123]

In the contractual and tort contexts, limited liability may be viewed as an allocation of the burden of insurance.[124] Even someone whose contact with a corporation is unexpected and arises only through the firm's tortious conduct is able to purchase insurance against the general risk of such contact. If added liability obliged all corporations to carry larger insurance policies in order to protect their shareholders, consumers often would ultimately pay for that insurance. Poorer individuals, however, may prefer not to purchase such insurance. The system of limited liability leaves them free not to do so.

Limited liability operates very differently in the context of criminal fines. The criminal fine is not fundamentally a compensatory payment. It is rather a mechanism for the prevention of undesirable conduct. Where limited liability blocks the operation of a fine, there is no reallocation of a compensatory insurance burden. There is instead a tradeoff: the state gives up a measure of crime prevention and a small amount of revenue in an effort to encourage collective enterprises. The state accomplishes this encouragement by foregoing the collection of certain money obligations, in effect providing a monetary subsidy to some enterprises.

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ing percentages of liability, any company could practically insulate its shareholders from superadded liability by making large pro rata repurchases from the stockholders for nominal consideration.

Superadded liability is not a freestanding penalty. It must be paired with a means of assessing liability within the wealth boundary. The fit with equity and pass-through fines is a simple one. In the case of the equity fine, superadded liability begins as soon as the corporation is unable to provide additional value in the form of stock. In the case of the pass-through fine, superadded liability simply removes the artificial cap of market value on the direct liability of the shareholder. The pairing of superadded liability with cash fines, however, requires care. Cash fines have a penalty effect in excess of their face value. Hence a penalty that exceeds the asset limit of the corporation does not necessarily call for superadded liability, even though the court will be unable to collect the full amount of the fine. Superadded contributions are needed only where the desired penalty exceeds the market value of the firm. *Cf. supra* text accompanying Figure 1.

122. *See* 13A W. FLETCHER, *supra* note 117, § 6273 & nn.2-7. For an application, see Bates v. Farmers Sav. Bank, 225 Iowa 232, 236, 280 N.W. 487, 489 (1938).

123. For historical examples see Anderson v. Abbott, 321 U.S. 349, 356-64 (1944); Metropolitan Holding Co. v. Snyder, 79 F.2d 263, 266-67 (8th Cir. 1935). Similarly, beneficial owners of shares were treated as shareholders. Nettles v. Rhett, 94 F.2d 42, 47-48 (4th Cir. 1938). More subtle devices for avoiding liability while retaining control and access to profits are treated *infra* in Part V.

124. *See* Meiners, *Does Limited Liability Subsidize Corporations at the Expense of Society?*, in THE ATTACK ON CORPORATE AMERICA: THE CORPORATE ISSUES SOURCEBOOK 223, 226 (M. Johnson ed. 1978); Meiners, Mofsky & Tollison, *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 366-67 (1979).

Two odd features of this subsidy are immediately apparent: it "dilutes the disincentives for the flouting of public policy,"[125] and indeed it is delivered solely to enterprises that violate that policy. These are not features of limited contractual liability, nor, in many contexts, of limited liability in tort.[126]

It is tempting to conclude that limited criminal liability is perforce an irrational subsidy. If the aim were only to sweeten the monetary rewards of collective enterprise, a cash subsidy could deliver the same funds to law-abiding enterprises without incurring unwanted side effects. But imagining the impact of a system of unlimited joint and several liability reveals that this is not so. If removing limited liability would impose a risk of ruinous liability regardless of an investor's level of commitment, a very large cash subsidy would be required to achieve the same incentive for collective enterprise that is achieved by the relatively small aggregate subsidy limited liability currently delivers to wrongdoers. This is because a risk of utter ruin has a much greater disutility than its discounted value based only on dollars lost would suggest.

This difficulty largely disappears, however, if liability remains limited to the stockholder's pro rata share of a fine. The typical shareholder in a vast publicly held enterprise would, as a practical matter, face but a remote risk of only nominal liability. Investors more heavily committed to an enterprise would have to contemplate a more substantial risk, commensurately with their greater ability to choose, monitor, and participate in management.[127] It is nonetheless difficult to imagine a crime in the line of business simultaneously so lucrative and so difficnlt to detect that it would call for a fine greater than a small multiple of the stockholders' equity in the corporation. The sole exception is where the violator is a small and undercapitalized enterprise—in other words, precisely the sort of shareholder controlled close corporation that is most likely to be tempted to take advantage of the wealth boundary.

Two benefits accrue from restricting fully limited liability to tort and contract, while opening up shareholder liability for criminal wrongs on a pro rata basis. First, superadded liability virtually eliminates the problem of the wealth boundary. In theory, of course, crossing the corporate

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125. Stone, *supra* note 66, at 69.

126. Strict product liability in tort, for example, seeks only to internalize in manufacturers the cost of product defects; it does not seek to prevent such defects if their cost is lower than the cost of avoiding them. Hence a manufacturer can incur liability even as it pursues the most cost-effective, socially desirable course of action. When limited liability protects such a manufacturer, a subsidy is delivered to a corporation acting in accord with public policy.

For a discussion of the merits of limited liability in tort, see Note, *Should Shareholders Be Personally Liable for the Torts of Their Corporations?*, 76 YALE L.J. 1190 (1967).

127. *See* Stone, *supra* note 66, at 75. It might be possible to provide stockholders with an option of paying others to assume this risk. *See infra* text accompanying notes 136-37.

wealth boundary (and all succeeding corporate wealth boundaries)[128] simply leads to a final impenetrable boundary: the limit of the shareholder's personal assets. On the rare occasions that mere pro rata liability could reach that boundary, however, the limit would be of modest significance as a matter of deterrence. An individual's last dollar is the most valuable, and even where the expected return of criminal conduct is mathematically positive, a loss that entails personal bankruptcy carries substantially more than its mathematical weight. Second, superadded liability for criminal wrongs would likely reduce shareholder indifference to the prospect of criminal penalties. The threat, however remote, of liability in excess of the value of the shares held would make investors more wary of crime-prone enterprises and would encourage those with substantial shareholdings to expect and press for management policies designed to prevent major criminal activity.

A pair of objections to superadded liability immediately spring to mind. One commentator, addressing tort liability, has suggested that shareholder liability could be a prescription for unwieldy litigation.[129] The government, however, is far better equipped than tort plaintiffs to collect large and small civil liabilities from numerous individuals without resorting to litigation; tax collection on the state and federal levels is a case in point. Superadded liability, moreover, would most often come into play against small and poorly financed enterprises that would be unlikely to have widely dispersed ownership.

The second potential objection grows out of the widespread assumption that limited liability, if not "the greatest single discovery of modern times,"[130] is at least an indispensable cornerstone of the twentieth-century economy.[131] If this is so, it might follow that superadded liability would, to an unacceptable degree, inhibit capital formation by intimidating potential investors.[132]

But the superadded liability proposed here leaves the vast bulk of limited liability intact: It is far more common for contractual or tort creditors to force a corporation into bankruptcy than for a fine to do so, and the remedies of such creditors remain limited to the corporate entity. Even the shareholder liability for criminal fines, moreover, remains tied

128. *See supra* note 123 and accompanying text.

129. Note, *supra* note 126, at 1196-98. The author of that Note proposes and evaluates fully unlimited (not pro rata) tort liability for shareholders, but to avoid unwieldiness he would restrict such liability to "close" corporations.

130. Address by Nicholas Murray Butler, President of Columbia University, at the 143d Annual Banquet of the Chamber of Commerce of the State of New York (Nov. 16, 1911), *quoted in* 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 21 (1st ed. 1917).

131. *But see* Meiners, Mofsky & Tollison, *supra* note 124, at 352 (the rule of limited liability may have no economically significant impact).

132. *But see* Coffee, *supra* note 10, at 422 (primary function of stock today is to serve as currency for control, rather than to raise capital).

to an individual's level of investment. The change in exposure for most investors, therefore, is not great. Investors would instead react to superadded liability by avoiding individual firms that appear to present a high risk of becoming involved in criminal activity.[133] There is no reason to suppose that investment advisers could not do a fair job of identifying such risky enterprises, particularly since management would have strong incentives to demonstrate its reliability to potential sources of investment.[134]

If investors desire additional precautions against excessive liability, at least one avenue is open that does not undermine the deterrent effectiveness of the proposed fines. Individual and even institutional investors can take shelter in mutual funds with sufficiently large and diversified holdings to absorb any potential liability.[135] It would remain in the interests of the funds, however, to identify and to control or avoid companies presenting a criminal risk. Indeed, because of their size the funds are better equipped to exact adequate guarantees of lawful conduct from those seeking their investment dollars than are individual investors.[136]

The additional risk of superadded liability could also be mitigated by devising an insurance scheme to protect shareholders who do not participate directly in management against personal liability. The most practical way of providing such insurance would be at the company level, rather than at the level of individual portfolios. Each company could offer every investor who is not also a manager participation in a group policy covering superadded liability on its own shares. The insurance would not, of course, cover the corporation's own liability; it would simply limit that of the shareholders. Insurance companies would adjust their rates and their willingness to insure to fit their evaluation of the likelihood of criminal conduct occasioning shareholder liability. To maintain share values and to preserve access to equity financing, it would be in the interest of management to satisfy insurers that coverage could safely be provided at low cost.[137]

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133. In analogous situations, where serious personal liability may theoretically arise from events beyond an actor's immediate control, it would be difficult to find evidence of widespread intimidation. *See* Note, *supra* note 19, at 1545.

134. For a discussion of the capabilities of investment analysts, see Coffee, *supra* note 10, at 422-23 & n.98.

135. From the standpoint of rational allocation of resources, there might be substantial benefits in a system that drives small investors—for whom careful investment analysis is not economically feasible—to pool their resources and to purchase superior guidance collectively.

136. Many funds avoid involvement with management disputes. These funds would influence policy only through the allocation of their investment dollars. For a discussion of the role of institutional investors in corporate governance, see Eisenberg, *supra* note 29, at 48-53.

137. The transaction costs of offering such insurance might greatly exceed the protection offered. Presumably, however, inexpensive ways of offering the insurance through a surcharge at the time of a purchase order could be devised.

By concentrating the risk of superadded liability in a single large institution, such an arrangement might achieve substantially more preconviction monitoring of management than is economically practical for individual stockholders in a corporation of fragmented ownership. On the other hand, by shielding shareholders from some of the immediate consequences of a conviction, insurance would sacrifice some potential for triggering shareholder revolt. More fundamentally, it would in some circumstances allow the expected gain to the shareholders of corporate criminal activity to remain positive, defeating the central purpose of corporate fines—though the ensuing rise in insurance rates would ordinarily prevent this effect. Shareholder insurance, therefore, should be considered only in contexts where mutual funds prove inadequate as a risk-pooling device.

V
THE PROBLEM OF PREFERRED SHARES AND NONSHAREHOLDER INTERESTS

The alternative fines discussed in this Comment share a common difficulty. They allocate the burden of a penalty by reference to a corporation's equity structure, and that structure can be both complex and manipulable. These approaches, in permitting more selective penalties, inevitably raise hard, but resolvable, choices as to the boundaries of the groups selected for penalization. The diversity of financial structures raises the question of how to classify the holders of preferred stock, debt securities, and the like. Should these investors be counted as shareholders in levying equity fines and superadded or pass-through contributions?

Cash fines penalize all of these groups, but they do so unevenly. A relatively small penalty may have virtually no impact on the holders of senior and debt securities, skimming only the profits destined for use in expansion or for distribution to common shareholders. A crippling fine, on the other hand, can fall far more heavily on one of the former groups than on the holders of common shares, since lenders or preferred shareholders may have supplied the bulk of the capital at risk.

This shifting of the burden bears no positive relationship to the profitability of criminal conduct to the different groups. On the contrary, the relationship may be inverse. Crimes producing modest gains tend to call for modest fines, while more lucrative crimes demand larger penalties. The larger the penalty, the greater its threat to basic solvency and the greater its relative impact on lenders as compared to stockholders. To the lenders, the last dollars of loss are the most significant. Where the benefits of criminal conduct are concerned, on the other hand, the first dollars of gain most improve the position of holders of senior and debt securities. As gains become larger, it is increasingly likely that the financial security needed to meet obligations to these parties will have been assured, and that additional dollars will constitute surplus that benefits only common shareholders, who have unlimited participation in profits. A given cash fine, therefore, is likely to penalize those other than common shareholders in an amount disproportionate to their expected gain from the criminal conduct. The penalty will also bear no necessary relationship to the relative abilities of the various groups to elect or influence management.

The equity fine, as envisioned by Professor Coffee, presents a different imbalance. Coffee would levy the fine in ordinary common stock alone.[138] Such an approach allows evasion. An equity fine levied in common stock subordinate to senior securities leaves intact not only the capital of a corporation, but the value of its senior securities as well. Yet the holders of such securities can benefit from criminal gains. To exempt them from punishment opens a loophole for evasion of the equity fine. Investors could allot among themselves a small class of common stock for voting purposes, together with a class of preferred stock so large as to effectively preempt the function of distributing profits. An equity fine might deprive them of control of the firm, but they would continue to hold senior rights to a large slice of its future earnings, thereby retaining a large part of its market value. The currency of equity fines, therefore, should be a special class of voting and participating senior securities having a dividend priority equal to that of the most senior current security but full rights to participate in further profits after senior obligations have been satisfied. Alternatively, the corporation could be required to assemble the fine by issuing new stock in each class of equity security in amounts proportional to the aggregate market value of each class.

Pass-through fines and superadded liability must likewise be designed to assess the holders of senior securities.[139] Assessments per share should similarly be weighted to reflect the differing market values of the various classes of stock. Thus conceived, equity and pass-through fines cannot completely eliminate the problem of disproportionality between penalty and expected gain for holders of senior securities. Marginal benefit to preferred shareholders inevitably diminishes as criminal conduct becomes more lucrative, whereas marginal benefit to common shareholders increases or remains constant. But unlike cash fines, equity and pass-through fines would never shift the burden of penalization

138. Coffee, *supra* note 10, at 413 n.77.

139. Historically, holders of senior securities have not been immune from personal liability arising from the ownership of shares, whether it be superadded liability or liability for unpaid subscriptions. *See* Nettles v. Rhett, 94 F.2d 42, 48-49 (4th Cir. 1938); John W. Cooney Co. v. Arlington Hotel Co., 11 Del. Ch. 286, 101 A. 879 (1917).

toward preferred shareholders as the crime becomes more profitable and the size of the fine increases.

Including all types of equity securities in an equity or pass-through fining system does not altogether remove the potential for evasion through manipulation of capital structure. If equity or pass-through fines simply replaced cash fines, some investors would gravitate toward debt financing. Those hoping to share in control and exponential profits would still need to retain common shares. They might nonetheless endeavor to take as large a portion of the profit as practicable through debt obligations.[140] Such obligations would retain their full value following a non-cash fine. In effect, they would offer a means of screening a portion of the market value of an enterprise from the reach of criminal penalties.

Superadded liability, however, eliminates the incentive for this type of evasive restructuring. When superadded liability supplements non-cash fines, shareholders gain nothing by putting a portion of market value beyond the reach of the initial fine; they simply become personally liable for any shortfall. Their interest in spreading this liability as widely as possible, moreover, would make them reluctant to permit any fellow investor to share substantially in profits without holding a stake in equity.[141]

This last feature of superadded liability—the need to spread liability—would discourage a means of evasion that can frustrate even cash fines. The example of LSP, Inc., is again illustrative.[142] Allied Chemical owned no stock in LSP, the thinly capitalized firm manufacturing Kepone for Allied's benefit. The stock belonged instead to two former Allied employees.[143] When LSP could not pay the fine it incurred, therefore, Allied lost no more than a source of supply. Superadded liability makes it no easier to reach the nonshareholding beneficiaries of corporate criminal activity if those beneficiaries have used straw men to hold the stock of the corporation. But by increasing shareholder risks, superadded liability would make it more difficult to find straw men willing to hold the shares of such an enterprise on their own.

140. Of course there will often be practical constraints on such leveraging. A corporation must show a reasonable cushion of equity financing in order to retain the confidence of commercial lenders, upon whose credit the enterprise may depend.

141. Superadded liability would guard against evasive capital structures even if shareholder insurance, *see supra* text following note 136, were permitted, because insuring a company with such a structure would probably be impossible.

142. *See supra* text aceompanying note 67.

143. Stone, *supra* note 85, at 5.

VI
Integrating Corporate Fining Alternatives

To a large extent, it is the very diversity of its applications that makes the corporate form a formidable barrier to effective social control. No single weapon is ideal in every situation. How might one best assemble a diverse and flexible arsenal for battling institutional crime?

First, corporate and individual penalties should work in tandem. Corporate fines remove the profit motive for misconduct; individual penalties combat personal motives. Next, the corporate branch of this dual approach calls for the integration of several mechanisms.

Aside from transaction costs and the risk of nullification, the pass-through fine performs marginally better than its counterpart levied on equity. Each has the fundamental advantage of eliminating overspill, thereby resolving the fairness concern that plagues cash penalties. Each provides an avenue for improved general and specific deterrence—the equity fine by altering the makeup of ownership, the pass-through fine by raising shareholder awareness of penalties. But the dramatic impact of a pass-through penalty makes it the more persuasive deterrent. Pass-through fines also provide a flexible record date for identifying shareholders to be penalized, and they surpass both cash and equity fines in ease of calibration.

Because pass-through fines can involve substantial implementation costs, and because they could be psychologically difficult to impose, they should not be the sole fining mechanism available to courts. In the realm of large penalties, equity fines provide a workable alternative. Both pass-through and equity levies, moreover, would benefit from an adjunct of superadded liability to enhance deterrence and guard against evasive manipulation of equity and debt structures.

Finally, pass-through and equity fines cannot wholly supplant cash fines. Neither alternative improves on cash fines as a vehicle for small penalties levied on public corporations—the pass-through fine because of administrative costs, the equity fine because it lacks the nuisance value to management that even a small cash fine can impose.

This Comment has explored fining alternatives without regard to their political practicality. It is unlikely that the integrated system of penalties proposed here could be adopted in its entirety. But this discussion points to the proper direction for reform. Reformers must acknowledge that shareholders are a fair and indeed a desirable target for corporate penalties. They should concentrate the impact of fines on this group, while choosing mechanisms that prevent any part of the corporate structure from ignoring or overlooking penalties. In many contexts the alternative fines explored in this Comment accomplish these ends, offering means of preventing corporate crime that are both fairer and more effective than those in use today.

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