Significant questions have been raised concerning the efficiency of criminalizing agency costs and the problems of excessive prosecution of crimes committed by corporate agents. This paper provides a new perspective on these questions by analyzing them from the perspective of agency cost theory. It shows that there are close analogies between the agency costs associated with prosecutors in corporate crime cases and those of the agents being prosecuted. The important difference between the two contexts is that prosecutors are not subject to many of the standard mechanisms for dealing with corporate agency costs. An implication of this analysis is that society must decide if prosecuting corporate agents is worth incurring the agency costs of prosecutors.

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INTRODUCTION

Commentators have long debated the costs and benefits of criminally prosecuting corporations and their agents. Recently commentators have focused on the significant leverage prosecutors have when prosecuting corporate crimes as well as the implications of this leverage for criminal procedure and the standards of corporate criminal liability.¹

This paper contributes to this debate by approaching the subject from the perspective of agency theory and analogizing abuses of power by prosecutors to those of corporate agents.² It shows that prosecutors' conduct involves many of the same agency cost problems as the corporate conduct they are prosecuting. At the same time, the sort of market and institutional mechanisms that can constrain corporate agents may not be effective for prosecutorial agents. Moreover, the particular challenges of corporate criminal prosecutions exacerbate prosecutorial agency costs in this context.

Agency analysis illuminates whether and to what extent corporate agency costs should be criminalized. The analysis shows that if the criminal justice system is used to punish corporate agents for harm they cause in the course of their employment, then society must tolerate increased costs associated with delegating discretion to its own agents, those who prosecute these crimes. Prosecutorial agency costs, in turn, must be taken into account in designing and weighing the costs and benefits of corporate agent criminal liability.

This paper does not suggest that prosecutorial agency costs are limited to the corporate context.³ However, focusing on prosecutions of corporate agents is justified by special considerations that apply in this context. First, the fact that prosecutors themselves are agents highlights the question


² Several commentators have used the agency framework to generally analyze prosecutorial conduct in the course of examining particular incentive effects. See infra note 9. This paper is a more complete overview and consideration of the policy implications of this agency analysis in the context of corporate crime.

whether analogous conduct by corporate agents is sufficiently serious to justify criminal sanctions. Second, special problems of corporate prosecutions heighten the abuse of prosecutorial power, including the difficulty of isolating responsibility for wrongdoing within organizations, the hazy line between criminal and non-criminal conduct in this context, and the particularly high cost of defending these cases. Third, the “revolving door” between prosecutors’ offices and corporate suites raises special questions about prosecutors’ incentives in exercising this power.

These considerations suggest that concerns with over-criminalization are particularly applicable to corporate agents even if they are not limited to this context. Given the availability of other mechanisms for disciplining agents and the particularly high costs of criminal prosecutions, these particular prosecutions are likely less efficient than criminal prosecutions generally.

Part I of this paper discusses agency costs in firms and how government and private firms deal with such costs. Part II applies agency theory analysis to prosecutors and shows that despite the agency costs associated with prosecutorial power, prosecutors face weaker institutional, regulatory and market discipline than corporate agents. Part III discusses ways to deal with prosecutorial agency costs, including the implications of these costs for the criminalization of corporations’ and their agents’ conduct.

I. AGENCY PROBLEMS IN FIRMS

This Part discusses the basic problem involved in criminal liability of corporate agents—that is, deviations between firms’ and agents’ interests, often referred to as agency costs. It is important to emphasize at the outset that there is nothing inherent in a crime’s being committed by a corporate agent in connection with her job that necessarily should insulate the conduct from criminal liability. There is no apparent reason why the criminal laws should apply to an individual’s theft from another individual but not to her theft from her employer. Such conduct can raise questions concerning the integrity of corporate governance generally, and therefore harm the capital markets. Moreover, just as the criminal law economizes on the cost of self-protective measures, including by expressing the public’s condemnation of the activity, so criminal sanctions against corporate agents may be more cost-effective than forcing firms to rely on contracts and the civil law.4

A key problem with criminalizing agency costs lies in finding the appropriate dividing line between civil wrongs and criminal conduct. There is only a hazy line between the conduct of corporate agents that deserves

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criminal sanctions and ubiquitous agent behavior best constrained by private governance mechanisms and non-criminal sanctions. This article does not attempt to analyze all the considerations that are relevant to the decision to criminalize corporate agents' conduct. Rather, it only discusses the implications of prosecutorial agency costs relevant to criminalizing corporate agent conduct.

This Part begins with a general analysis of agency costs and then turns to specific ways to minimize these costs. This discussion has two purposes. First, a brief look at the well-trodden area of corporate agency costs provides a familiar context for the discussion below of identifying and determining ways to constrain prosecutorial agency costs. Second, showing the alternative mechanisms for dealing with agency costs provides background for Part III's discussion of the role of prosecutorial agency costs in determining whether to criminalize corporate agent behavior.

A. Agency Costs in General

Agency costs are a venerable concept in the corporate literature. Adam Smith observed in his Wealth of Nations that while the market's invisible hand guides property owners' selfish behavior toward society's good, this is not necessarily the case when the property is managed by agents: "Being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which partners in a private copartnery frequently watch over their own." Jensen and Meckling later modeled more precisely how the disparity of interests between owners and creditors can cause the shareholders to control the firm in a way that maximizes their own wealth but not that of the firm as a whole, including its creditors. Jensen and Meckling also observed that agency costs can be controlled by the principal's "monitoring" of the agent and the agent's "bonding" to provide some assurance of good behavior and thereby induce the principal to employ him or pay a higher wage. The principal bears the "residual loss" left by gaps in monitoring and bonding.

Agency costs are never zero because there is always some cost of hiring a non-owner agent to manage property. Agents and principals therefore necessarily bear some combination of monitoring and bonding costs and residual loss. The principal may spend nothing on monitoring and get no bond from the agent but bear a lot of residual loss from cheating. At the other extreme, the principal can reduce residual loss to zero by monitoring

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5 See ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776).
the agent’s conduct very closely or credibly threatening to severely punish the agent for cheating. But close monitoring has direct costs by reducing the benefits of delegating power to agents and indirect costs by deterring the agent from engaging in conduct that benefits the principal.

Agency cost theory is critical in analyzing the behavior and appropriate regulation of corporate executives. As with Jensen and Meckling’s shareholders, executives exercise power over corporate resources on behalf of others, including the shareholders, who finance the firm’s acquisition of the resources. The corporation’s financiers benefit from delegating power to agents because it enables them to focus on what they do best and leave management to the specialists. But the delegation also entails agency costs because the agents do not fully own the property they are managing. The firm must control these costs through the optimal mix of monitoring and bonding costs and residual agency loss.

B. Strategies for Controlling Agency Costs in Firms

There are myriad potential strategies for controlling agency costs. Consider the following illustrations from the corporate context.

1. Monitoring and Incentives

The firm can establish devices for examining agents’ behavior, rewarding good conduct and punishing bad. For example, independent directors can supervise managers, shareholders can vote on certain corporate acts and to elect the board, courts can enforce fiduciary duties and remedies, corporate agents can be required to disclose information concerning the quality of their management, and incentive compensation can align shareholder and manager incentives.

2. Investor Exit

The firm can enable investors to withdraw their capital by selling shares back to the firm, thereby forcing firm managers to go into the market to replace this capital. This strategy disciplines managers because the market price for new capital depends on manager quality. Additionally, the firm can enable shareholders to sell management and economic rights to

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third party governance experts who can aggregate voting power to take control of the firm away from bad managers. 8


Limiting the extent to which agents can bind the firm addresses the source of agency problems by reducing the agent’s control over the firm’s property or ability to expose the firm to harm or liability.

4. Criminal Liability

The main question for this paper is the extent to which the public needs to get involved in prosecuting corporate agency costs given the other potential ways of dealing with the problem discussed above. Answering this question involves a comparison between the costs and benefits of internal firm devices and those of using the criminal law.

Criminal penalties can be efficient in some agency situations, as firms may lack either adequate market incentives to control agents or the power to do so. For example, the agent may engage in hard-to-detect fraud or cause harm that primarily affects the public but that increases the firm’s short-term profits and the agent’s compensation. Criminal penalties may be justified in these situations if their benefits in reducing social harm, considered in the light of other constraints on agents’ conduct, outweigh their social costs, including deterring honest executives from engaging in socially productive risk-taking. The net benefits of criminalizing corporate agency costs also reflect the fact that criminal penalties are administered by other agents—prosecutors— who are subject to their own set of agency costs.

II. PROSECUTORS AS AGENTS

Like corporate executives, prosecutors are agents in the sense that they exercise their power to execute the criminal laws on the government’s behalf rather than their own. 9 Society as a whole receives much of the benefit

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and incurs the costs of the prosecutors' actions, with the brunt falling on individual criminal defendants. The prosecutorial context shares the following general characteristics with agency costs in firms: (1) delegation of control by the principal to the agent; (2) the agent's imperfect incentives to maximize the controlled assets' value because the agent does not bear all the costs and benefits of her conduct; (3) the principal's monitoring and agent's bonding expenses incurred to control agency costs; and (4) residual loss incurred by the principal because monitoring and bonding are not fully effective. The following subparts discuss some details of these shared characteristics.

A. Delegation of Control

Prosecutorial agency costs, like agency costs in other contexts, arise because of prosecutors' broad discretion in deciding which crimes are prosecuted and their power to affect the nature of the prosecution. This subpart discusses specific sources of this discretion.

1. Power to Decide Which Crimes are Prosecuted

Prosecutors have significant leeway to decide which crimes to prosecute. This raises the question whether they exercise this power consistent with the interests of their principal—the state.

Prosecutors' discretion derives from uncertainty as to when behavior is criminal. Harvey Silverglate has chronicled many situations in which prosecutors are empowered by the vagueness and breadth of criminal laws, including those relating to sale of prescription narcotics and public corruption. In the business context it may be particularly unclear when behavior crosses the line from hard-nosed competition that is at most subject to a civil action to what society considers criminal. For example, it may not be clear how to distinguish aggressive but legitimate competitive behavior from criminal violations of the antitrust laws, between clever tax shelters and tax fraud, or between disclosures and accounting that are technically accurate and those that are criminally misleading. By contrast, most non-

(showing how prosecutorial incentives, including risk aversion, matter in deciding whether prosecutions should be mandatory or selective); Eric Rasmussen, Manu Raghav & Mark Ramseyer, Convictions Versus Conviction Rates: The Prosecutor's Choice, 11 AM. L. ECON. REV. 47 (2009); Daniel C. Richmond & William J. Stuntz, Al Capone's Revenge: An Essay on the Political Economy of Pretextual Prosecution, 105 COLUM. L. REV. 583 (2005) (discussing prosecutors' incentives in using crimes as pretexts to punish other activity).

10 See generally, Silverglate, supra note 1.

corporate criminal behavior is criminal because it breaches clear social norms.

Prosecutorial discretion is enhanced by the increasing breadth of criminal law, particularly federal criminal law. A notorious example is "honest services" fraud, which permits the government to prosecute virtually any kind of agent misconduct. Although the Supreme Court interpreted this provision to reach only bribes and kickbacks, this still leaves prosecutors with significant discretion. Many federal crimes have loose mens rea standards, which simplify prosecution and increase prosecutorial discretion. Also, federal prosecutors need not wait until criminal violations are brought to their attention. They can investigate notorious or unpopular behavior and find crimes in the course of the investigation, or that occur as a result of it (particularly lying to investigators), but that have little or nothing to do with the public concern that gave rise to the investigation.

It can be particularly hard to define when corporate agents' behavior crosses the line into criminal conduct. The basic problem, as discussed in Part I, is that agents' incentives are never perfectly aligned with their principals' interests and agency costs are never zero. It follows that agents often cheat at least a little bit. The line between conduct that triggers these intra-corporate or civil remedies and conduct that is criminal is therefore

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13 See 18 U.S.C. § 1346 (West 2011) (defining "scheme or artifice to defraud" for purposes of mail fraud and other federal statutes as including "a scheme or artifice to deprive another of the intangible right of honest services"). See also Podgor, supra note 12 at 1579-80 (discussing breadth of mail fraud statute).


15 See BRIAN W. WALSH & TIFFANY M. JOSLYN, WITHOUT INTENT: HOW CONGRESS IS ERODING THE CRIMINAL INTENT REQUIREMENT IN FEDERAL LAW (2010), available at http://www.heritage.org/research/reports/2010/05/without-intent (describing large number of federal statutes that do not have mens rea requirement); Geraldine Moohr, What the Martha Stewart Case Tells Us About White Collar Crime, 43 Hous. L. Rev. 591, 601 (2006) ("There is no definition of the culpability, or mens rea, element of "willful" in the criminal statute. In this vacuum, courts have applied standards that are strikingly similar to the civil scienter standard to criminal cases."); Podgor, supra note 12 at 1580-81 (discussing lack of mens rea requirement as contributor to prosecutorial discretion).

16 See Richman & Stuntz, supra note 9, at 609 (discussing "strategic" crimes used as a pretext for criminal prosecutions, such as that against Al Capone); Podgor, supra note 12 at 1580 (discussing prosecutorial discretion to use "short-cut" offenses such as perjury and obstruction of justice to obtain convictions on less evidence that would be required to prove the main crimes such as accounting fraud). For examples, see infra text accompanying notes 46-47.
murky. Among other things, conduct that is questionable in hindsight because of media attention or its connection with broader wrongdoing might have been approved by the appropriate corporate decision-makers when the wrongdoing was less obvious. Even if the decision-making process is imperfect, perhaps because it involves other agents who are subject to the defendant’s control, the firm’s owners have explicitly or implicitly accepted the process. Such conduct may be closer to ordinary agent behavior than to criminal theft.

Consider two recent prosecutions of corporate agents. First, Dennis Kozlowski, former Tyco CEO, was convicted and sentenced to hard time on Riker’s Island.\(^\text{17}\) As one observer commented:

Kozlowski wasn’t convicted for overspending, nor for defrauding investors—the most common charges leveled against corrupt CEOs. He was convicted instead of grand larceny, that is, of stealing his bonuses, which were certainly oversized. But even if you believe the worst about Kozlowski and his co-defendant former Tyco CFO Mark Swartz, they were paid according to a contract, and that is not stealing.\(^\text{18}\)

The jury ultimately concluded otherwise, which highlights the fine line between “stealing” and getting paid what a significantly lower-paid jury later concludes is too much.

The other example concerns Lord Conrad Black, who was convicted of mail fraud and obstruction of justice and later freed by the Supreme Court’s opinion limiting the use of the honest services theory the government used to convict him.\(^\text{19}\) The conviction was based on conduct arising out of a sale of control\(^\text{20}\) and involved an offense that may or may not even give rise to a civil claim. The case focused on the legitimacy of a non-competition agreement that, as in Kozlowski, the board may have approved. One of the directors was former U.S. attorney and Illinois Governor Jim Thompson. Despite the trial’s publicity it never became clear why Black was charged when the directors who enabled his scheme escaped trial.

The cases that emerged from the highly publicized backdating of stock options provide another illustration of prosecutors’ power to decide what to prosecute. Although in hindsight the conduct (misreporting option grant dates) might have seemed to be fraud or breach of fiduciary duty, a closer look from the perspective of when the relevant decisions were made reveals that the conduct more closely resembled standard agent behavior that was not clearly contrary to shareholders’ interests. The conduct was very com-

\(^{19}\) Black v. United States, 130 S. Ct. 2963 (2010).
mon,\textsuperscript{21} suggesting that it conformed to norms of corporate behavior. The questions concerning the criminalization of backdating include whether the market was misled, the actual grant dates, the credibility of the relevant accounting rules, whether corporate agents authorized or vetted the relevant conduct, and the business purposes of the conduct, including the firms’ need to attract qualified employees.\textsuperscript{22}

In addition to the hazy line between criminal and non-criminal agent cheating, there are additional problems with allocating responsibility for harm to particular agents. Corporate conduct is inherently group conduct. Firms typically divide responsibility among specialists then coordinate these individuals’ behavior. Criminal prosecutions must penetrate these organizational decisions in order to affix individual responsibility. For example, an important issue in the Gregory Reyes-Brocade backdating case was whether Brocade’s finance department shared knowledge of the backdating with Reyes.\textsuperscript{23}

Finally, even if an agent’s conduct might be deemed criminal, there still may be questions about whether the individual defendant had the requisite criminal state of mind. Circumstantial evidence of a defendant’s state of mind may be open to many interpretations, particularly when placed in its full context. As discussed further below, defendants’ discussions of possible risks or concerns do not necessarily indicate that they thought the problems needed to be disclosed. Also, defendants’ candid discussion of problems does not necessarily indicate their consciousness of wrongdoing, particularly since the criminality of the conduct may shift after the statements were made.

These ambiguities relate not only to what must be shown in order to justify criminal penalties. They also relate to prosecutors’ power to decide when to prosecute corporate agents and therefore to the agency costs associated with the exercise of that power. The important question is whether the costs of delegating this discretion to prosecutors outweigh the benefits in this context.

2. Power to Manage the Trial: Imperfections in the Adversary System

Prosecutors have significant power to decide not only whether but how to prosecute a case. Ideally, the adversary system would check this prose-

\textsuperscript{21} See Randall A. Heron & Erik Lie, \textit{What Fraction of Stock Option Grants to Top Executives Have Been Backdated or Manipulated?}, 55 MGMT. SCI. 513, 513 (April, 2009) (finding that almost 20% of management options were backdated during the study period).


cutorial power. However, several features of corporate criminal cases limit the adversary system’s ability to constrain such power.

First, prosecutors can inflict significant costs just by deciding to prosecute, even before the adversary system comes fully into play. High-profile defendants or potential defendants, who are frequent prosecutorial targets, may suffer substantial reputation loss and defense costs even if they are ultimately exonerated.24

Second, prosecutors can avoid having to test their theories at trial by using significant leverage to virtually force even innocent, or at least questionably guilty, defendants to plead guilty.25 Corporate employees usually have far less resources, including legal talent, computer resources, access to experts, and funds for general litigation support, than prosecutors. Accordingly, the defendant faces a strong temptation to plead guilty to avoid a higher penalty than the mismatch of resources could yield at trial. A notorious illustration involved Jamie Olis, a minor player in an accounting fraud case. He maintained his innocence but could not afford to adequately defend a case in which the government used computer programs to sort through twelve million pages of documents. Simply printing those pages would have cost Olis $100,000.26 Because of government pressure on Olis’s employer, Olis’s defense team had only about $14,000 for his defense.27 Olis was convicted and sentenced to a twenty-four-year prison sentence.

Third, the threat of lengthy sentences like Olis’s increases defendants’ incentive to settle. These sentences often depend on the harm the defendant’s misconduct allegedly caused as reflected by the fall in the firm’s stock price. It is very difficult to isolate the effect of the fraud and the defendant’s involvement in it on the stock price. These problems ultimately helped persuade a court to significantly reduce Jamie Olis’s sentence from twenty-four years to seventy-two months based on an “intended loss” measure of harm.28 However, risk-averse defendants may focus on their potential exposure rather than the possibility of a similar reduction.

25 See Griffin, supra note 1, at 311-13; Ribstein, A Question of Costs, supra note 1, at 857-60. Several of the stories in Silverglate, supra note 1, arguably involve this scenario.
26 Paul Davies & David Reilly, Executives on Trial: In KPMG Case, the Thorny Issue of Legal Fees, WALL ST. J., June 12, 2007, at C5.
Fourth, prosecutors can pressure corporate agents through their firms. Like individual defendants, firms face strong incentives to plead guilty to avoid even worse penalties at trial. These penalties could include fatal sanctions for firms that must stay clean to continue in business, like those imposed on Arthur Andersen. Unlike individuals, firms can negotiate for deferred prosecution agreements (DPAs) in which the firm agrees to governance arrangements in order to avoid prosecution. The firm’s ability to get a DPA depends on its cooperation with the prosecution which, in turn, may require the firm to induce its agents to cooperate with investigators. Accordingly, firms seeking DPAs have strong incentives to deny agents advancement or indemnification of expenses and to waive the attorney–client privilege. Employees may find themselves having to talk to corporate attorneys without the protection of an attorney–client privilege. Given the high defense costs discussed above, indemnification and advancement can mean the difference between a defendant’s ability to mount a defense and having to plead guilty. These issues surfaced in the KPMG case, in which the government pressured the defendant accounting firm, which faced the possibility of following Arthur Andersen to extinction, to deny its employees advancement and indemnification.

Fifth, prosecutors can unilaterally determine the shape and scope of the trial by threatening potential defense witnesses. By compiling a long list of unindicted co-conspirators, prosecutors serve notice on defense-friendly witnesses that they may become defendants who lack immunity from prosecution if they testify. The Enron case, for example, had approximately one hundred unindicted co-conspirators who had good reason to keep silent at trial about their conversations with main defendants Ken Lay and Jeff Skilling. If defendants tried to exert similar leverage on prosecutors’ witnesses, the government could charge them with a crime. This asymmetry exacerbates the problem.


31 See Silverglate, supra note 1 at 138-52; Ribstein, A Question of Costs, supra note 1, at 870-73; United States v. Stein, 495 F. Supp. 2d 390 (S.D.N.Y. 2007), aff'd United States v. Stein, 541 F.3d 130 (2d Cir. 2008) (The trial court ruled that the government’s pressure violated defendants’ Fifth and Sixth Amendment rights and dismissed several of the indictments).

32 John R. Emshwiller, Will Enron Probe Spawn Further Criminal Cases?—Flush with Conviction Victories, Prosecutors Have Possible Targets but May Be Set to Wind Down, WALL ST. J., June 6, 2006, at C1.

The courts have only limited ability to police illicit prosecutorial pressure on witnesses. In the Broadcom backdating case, particularly egregious prosecutorial conduct caused defendants to plead guilty to crimes they knew they had not committed, which resulted in a court in the Central District of California dismissing the case and even rejecting a guilty plea. But such judicial discipline is rare. Even if interview transcripts show changes in witnesses' testimony, a court may see such changes as indicating only that the witnesses finally saw the light.

B. Imperfect Incentives

Prosecutors' substantial power might not be a concern if their incentives in exercising this power were perfectly aligned with the principal's (i.e., society's) interests. However, as with corporate and other agents, this is not the case for several reasons.

First, prosecutors stand to gain individual benefits that depend partly on the case's notoriety, even though prosecuting the case may not be in society's interests. Prosecutors who have handled such cases are valuable to prominent firms who want prominent hires and emblems of corporate integrity. Prosecutors' jobs therefore may become revolving doors into lucrative and prestigious careers, with their newly-minted firm jobs providing, in effect, contingent fees for public prosecutions. This is particularly relevant for U.S. Attorneys, short-term employees whose terms depend on which political party is in power. A study of the careers of 570 former U.S. Attorneys found that immediately upon leaving office 9.12% became federal judges, 7.9% became state judges or were appointed to positions in state or local government, 19.65% practiced in large firms, 39.12% joined small firms, 1.93% were elected to political office and 9.47% were appointed to another position in the federal government. Another study showed that U.S. Attorneys tend to prosecute individuals with relatively high human capital as indicated by such factors as success in their non-criminal careers. The defendants' wealth reflects notoriety and political salience and is correlated with the corporate nature of the crimes. Working on cases with these attributes makes prosecutors even more attractive to corporate litigation firms, often allowing them to move directly into corporate de-

36 See Boylan, supra note 9, at 383.
37 See Glaeser et al., supra note 9, at 269.
fense.\textsuperscript{38} Although this data focuses on U.S. Attorneys, who are most likely to use the revolving door, these prominent corporate crime cases affect staffers' careers as well.\textsuperscript{39} For example, many Enron prosecutors found lucrative jobs in the private sector.\textsuperscript{40} Moreover, U.S. Attorneys set their offices’ policies and priorities.

Second, increasing the number of successful prosecutions can make the revolving door more lucrative, and thereby increase the incentive to bring prosecutions even if they are not in society’s best interests.\textsuperscript{41} Creating and expanding theories of criminal liability may increase the private sector’s demand for former prosecutors who can defend firms from these charges and counsel them on how to avoid criminal liability.\textsuperscript{42} In other words, prosecutors turn up the fire so they can sell extinguishers.

Third, prosecutors are subject to political pressures whether or not they aim for the private sector. This is true both of elected state prosecutors\textsuperscript{43} and federal and state prosecutors appointed by elected politicians.\textsuperscript{44} Congress can call federal prosecutors to account for failing to prosecute and has an incentive to do so as an easy response to public demand for action. These considerations encourage prosecutors to initiate investigations against defendants who have incurred popular wrath, such as Ted Stevens, Mike Milken, Jeff Skilling, Dennis Kozlowski, Ken Lay, and Conrad Black.\textsuperscript{45} As

\textsuperscript{38} To be sure, there are other explanations. The authors attribute the choice of defendants partly to a desire for skill accumulation because the cases will be more vigorously contested. They also recognize that focusing on these defendants may be an efficient use of prosecutors’ time because these defendants tend to get longer sentences, reflecting greater deterrence value. See id.

\textsuperscript{39} The focus on U.S. Attorneys is significant for the additional reason that federal prosecutors likely have greater resources than state or local prosecutors to pursue high-profile cases. Thus, below the federal level wealthier defendants may be escaping prosecution.

\textsuperscript{40} See Carrie Johnson, After Enron, Fighting Off the Job Offers, WASH. POST, June 5, 2006, at D2.

\textsuperscript{41} There is evidence that elected prosecutors tend to maximize conviction rates. See Sanford C. Gordon & Gregory A. Huber, Citizen Oversight and Electoral Incentives of Criminal Prosecutors, 46 AM. J. POL. SCI. 334 passim (2002); Rasmussen et al., \textit{supra} note 9, at 74. It is not clear this would apply to federal prosecutors who are subject to less political discipline and resource constraints than state prosecutors.


\textsuperscript{43} See supra note 41.

\textsuperscript{44} See Podgor, supra note 12 at 1573-77 (discussing investigations of politically motivated actions by federal prosecutors).

discussed above, these investigations can lead to charges that may have little to do with the conduct that irked the public. For example, an illuminating New York Times story detailed how prosecutors set out to nab Ken Lay in response to popular demand for his scalp and then searched for a legal theory on which to base their prosecution.47

To be sure, defendants’ notoriety at least partly reflects society’s condemnation of the defendants’ conduct, and therefore whether the cases should be brought. But the public’s judgment may reflect heated press coverage more than the considered judgment of legal and financial experts. For example, backdating, though vividly scandalized in Pulitzer Prize-winning articles in the Wall Street Journal, was in fact a murkier tale of unclear contracts, fuzzy norms, and irrational accounting rules.49 Also, some corporate crime prosecutions, such as those of the Enron and Bear Stearns hedge fund managers, involve a “bank run” scenario where the need for and accuracy of disclosures changes rapidly while the firm swiftly unravels.51

An indication of media skewing of prosecutorial incentives is what might be called the “corporate crime lottery” in which cases are more likely to be brought against unpopular executives of failing firms, such as Jeff Skilling of Enron Corporation, than against popular executives of successful firms, such as Michael Dell, Steve Jobs, and Warren Buffett. For example, Apple’s popular chief executive Steve Jobs escaped punishment for conduct connected with backdating that was arguably similar to the conduct that sent Gregory Reyes of the more obscure Brocade Communications to jail.52 The deterrence value of prosecutions seems unrelated to whether defendants are running failed or successful firms. Indeed, the “lottery” may weaken deterrence by creating a perception that the criminal laws are being used to punish failure rather than crimes.

46 See supra note 16 and accompanying text.
49 See Jenkins, supra note 22, at A13.
Skewed prosecutorial incentives are particularly important in corporate crime cases because they encourage prosecutors to bring and win especially difficult cases. Because of the problems discussed above of proving scienter and wrongfulness in corporate crime cases, the availability of solid evidence of criminal conduct may not keep pace with pressures on prosecutors to bring cases. This may motivate prosecutors to cut corners.\footnote{See supra Section II.A.2 (illustrating some corner-cutting prosecutorial behavior).}

C. Disciplining Prosecutorial Agents

As discussed in Part I, corporate agents are subject to a wide variety of institutional and market disciplines. However, this subpart shows that similar monitoring, bonding, and other mechanisms are not as available or effective in the prosecutorial context as in the corporate agent context.

1. Incentive Compensation

Designing incentive compensation for prosecutors presents significant challenges. Even in private law firms in which lawyers produce a clear financial output in the form of fees, there is controversy over whether billable hours or lockstep seniority-based compensation provides the best overall incentives.\footnote{See generally Roger Bowles & Goran Skogh, Reputation, Monitoring and the Organisation of the Law Firm, in ESSAYS IN LAW & ECONOMICS: CORPORATIONS, ACCIDENT PREVENTION & COMPENSATION FOR LOSSES 33 (Michael Faure & Roger Van den Bergh eds., 1989) (analyzing various law firm incentive mechanisms); Ronald J. Gilson & Robert Mnookin, Sharing Among the Human Capitalists: An Economic Inquiry into the Law Firm and How Partners Split Profits, 37 STAN. L. REV. 313 (1985) (explaining seniority-based compensation as a way to diversify risks and motivate lawyers to invest in building firm capital); Larry E. Ribstein, The Death of Big Law, 2010 WIS. L. REV. 749, 755-56 (2010) (discussing various compensation mechanisms); Larry E. Ribstein, Ethical Rules, Agency Costs, and Law Firm Structure, 84 VA. L. REV. 1707, 1718-19 (1998) (discussing various compensation mechanisms).} The compensation design challenge is greater for prosecutors because there is no measure of the value of prosecutorial efforts. Obviously a simple metric such as number of prosecutions would skew incentives, in that it may induce prosecutors to ignore the social costs of misguided prosecutions. One author has proposed compensation based on convictions of charged crimes with deductions for findings of prosecutorial misconduct.\footnote{Tracey L. Meares, Rewards For Good Behavior: Influencing Prosecutorial Discretion & Conduct With Financial Incentives, 64 FORDHAM L. REV. 851, 901-02 (1995).} However, this could skew incentives toward, for example,
undercharging defendants and over-caution. On the other hand, tests that try to take more factors into account would be very costly to apply.

2. Fiduciary Duties

Courts supervise agents via liability for agent self-dealing. Courts can apply this measure with relative ease because it does not require a determination of how much the fiduciary has hurt the firm. Non-self-dealing misconduct can be disciplined in other ways, such as relying on market demand for the fiduciary's services to punish a fiduciary with a poor reputation. However, there is no comparable self-dealing-based theory for disciplining prosecutors because their self-benefit from non-socially-regarding prosecutions or failures to prosecute is usually unclear except in the bribe situation. Even prosecutors who use the revolving door into private practice do not thereby signal prosecutorial disloyalty to the public interest. Courts and other agencies must find clear evidence of wrongdoing, which helps explain the failures to discipline errant prosecutors discussed below in this part.

3. Civil Liability

Prosecutors have absolute immunity in connection with prosecutions and qualified immunity when acting as investigators or administrators. Prosecutors theoretically may be criminally liable for violating defendants' constitutional rights, but one writer found only one conviction under the relevant statute, which was adopted in 1866. This stark difference between the broad potential liability of corporate agents and non-existent liability of prosecutors might be due to the fact that prosecutors have weaker positive incentives than private sector agents and therefore are more likely to be deterred from socially valuable conduct by the risk of liability. What-
ever the explanation, the absence of sanctions leaves errant prosecutors less constrained than corporate agents.

4. Monitoring and Discipline

Prosecutors may be subject to several types of discipline apart from civil or criminal liability. First, prosecutors are subject to political discipline either by direct election or by political appointment. But political discipline may be less effective because much of the social costs of misguided prosecutions are imposed on a small number of criminal defendants. Voters may care about unfairness, particularly since they also face a risk of mistreatment. This may be particularly true for marginally criminal white-collar prosecutions, which threaten even law-abiding people. On the other hand, because such white-collar prosecutions are concentrated against corporate executives, the middle class might be even further removed from these crimes than from workaday crimes such as drug possession. In other words, political discipline of prosecutorial over-reaching may be a function of social class.

Second, the grand jury is a potential constraint against frivolous criminal litigation. The grand jury protects defendants from having to incur the expense of defending against unfounded accusations. However, this is only a rough screen given the ex parte nature of the proceeding and grand jurors' tendency to rely on prosecutors.

Third, prosecutors are monitored by their superiors in the prosecutor's office, who may have incentives to protect the office's long-term reputation. However, there are several limitations on such administrative monitoring. High-level state and federal prosecutors are vulnerable to "revolving door" incentives and may be even more subject to political pressure for prosecutions and convictions than career staffers. Civil service job protection also limits prosecutors' ability to discipline their subordinates, who may claim that the discipline is politically motivated. Further, some pros-

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63 See Gordon & Huber, supra note 41, at 336 (noting that "citizens would like to avoid being unfairly singled out for punishment. At the same time, they would also like to live without fear of being victimized by the criminal acts of others.").
65 It has been said that a good prosecutor could indict a ham sandwich. Perhaps the main constraint provided by a grand jury is that only a good prosecutor can indict a ham sandwich.
66 See supra text accompanying notes 36 and 39.
67 For example, the George W. Bush Administration faced charges of political motivation in connection with its 2006 firings of several U.S. attorneys. See U.S. DEP'T OF JUSTICE, AN INVESTIGATION INTO THE REMOVAL OF NINE U.S. ATTORNEYS IN 2006 (2008), available at
Ecutorial misconduct can be hard to detect, such as failures to disclose exculpatory evidence to defendants. These factors help explain the almost total lack of internal discipline of prosecutors despite substantial indications of prosecutorial misconduct.68

Fourth, prosecutors are subject to potential discipline under attorney ethics rules. However, evidence of prosecutorial misconduct is hard to come by.69 To be sure, "prosecutorial misconduct" may include simple mistakes that justify reversal but do not warrant severe sanctions. But the minimal frequency of internal and external discipline at least indicates that even serious mistakes are not punished.

Fifth, courts can punish misconduct by sanctioning or censoring prosecutors or by dismissing a case. Courts exercised these powers in recent corporate crime cases, including the Broadcom, Reyes, and KPMG cases discussed above. Again, however, such discipline is likely to be rare.70 Many federal judges were themselves prosecutors71 and therefore are likely to sympathize with their successors. Moreover, judges have the same difficulty evaluating prosecutors' conduct as they do second-guessing the business judgment of corporate directors.

The deficiencies in the incentives of existing monitors of prosecutorial misconduct suggest potential gains from adding to the mix a public ombudsman, who would have better incentives. A public ombudsman positioned in prosecutors' offices could be insulated from political pressures and might not be as susceptible as a prosecutor to "revolving door" motiva-

www.justice.gov/oig/special/s0809a/final.pdf. The resulting publicity and investigation may have impeded even clearly non-politically motivated discipline of U.S. attorneys during this period.

68 See Bibas, supra note 56, at 446 n.16 (citing 1999 study by the Chicago Tribune finding no evidence of public sanctions following 381 reversed convictions resulting from prosecutorial misconduct and 1998 study by the Pittsburgh Post-Gazette finding few prosecutors punished for failing to turn over exculpatory evidence); Brad Heath & Kevin McCoy, Federal Prosecutors Likely to Keep Jobs after Cases Collapse, USA TODAY (Dec. 10, 2010, 2:03 PM), http://www.usatoday.com/news/washington/judicial/2010-12-08-prosecutor_N.htm. See also, Richman & Stuntz, supra note 9, at 610 (noting lack of discipline of U.S. attorneys by the Department of Justice).


71 See supra text accompanying note 36 (noting that a significant percentage of U.S. attorneys become judges).
tions. An ombudsman embedded in the prosecutors’ office would have access to critical institutional knowledge and the opportunity for timely intervention in case selection and management.

However, an additional monitor might not achieve the desired result. A lone representative of the public would face significant resistance from highly motivated prosecutors who ultimately control critical information. Also, powerful ombudsmen could cripple beneficial investigations because of their political ambitions or incomplete information.

A related possibility is to more clearly separate the functions of investigating possible crimes and prosecuting the claims that have been discovered. This could involve rejecting task forces like those organized in the wake of major events, of which the Enron task force is a notorious example. Integrating these functions may yield benefits such as leveraging specialized knowledge. However, these benefits may be offset by the tendencies of task forces to see the crimes they were commissioned to find and yield to political pressure or “revolving door” temptations. Referring the findings of the investigative body to a separate prosecutor would force review of the initial decision and therefore provide some check on any agency costs and behavioral biases of both offices.72

5. Market or Reputational Penalties

Prosecutors, like corporate agents, have incentives to act consistently with society’s interests even without legal monitoring mechanisms. Prosecutors must be concerned about their reputations because they interact with defendants’ lawyers and judges throughout their careers, whether in private or public practice. While prosecutors could advance their careers by aggressive behavior that wins cases, they might instead suffer professionally if the tactics backfire and they lose the case. In this respect, the revolving door from the prosecutor’s office to a judgeship, elected office, or private practice73 can act as a positive incentive.

While market discipline of prosecutorial conduct has an effect on prosecutors’ behavior, the effect is almost certainly less than that for corporate agents. The key difference is that while citizens have only the “voice” or political method of objecting to prosecutors, shareholders have the “exit” option regarding corporate investments.74 Shareholders have many invest-

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72 See Nuno Garoupa, Anthony J. Ogus & Andrew Sanders, The Investigation and Prosecution of Regulatory Offences: Is There an Economic Case for Integration?, 70 CAMBRIDGE L.J. (forthcoming 2011) (discussing the related issues in the analogous context of formal separation of these functions in Europe).

73 See supra note 36 and accompanying text.

74 See ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).
ment opportunities, and robust securities markets ensure that market prices swiftly reflect news of agents’ cheating. However, investors and managers have less opportunity to avoid costs imposed by federal prosecutors.

III. PROSECUTORIAL AGENCY COSTS AND CORPORATE CRIMINAL LIABILITY

Corporate criminal prosecutions face agency costs that are at least as great as, if not greater than, the agency costs found in the firms they target. Prosecutors hold great power and have incentives to misuse this power. They are also less disciplined by markets, institutions, and liability rules than are corporate agents. The result is misguided and mismanaged prosecutions that are costly both for taxpayers and firms. This Part examines some possible reforms that could address this problem.

A. Increasing Constitutional Constraints on Prosecutors

Prosecutors derive much of their power from the high costs that defendants must pay to fully utilize the adversary system. A possible response is to help the adversary system police prosecutors by reducing the asymmetry in prosecutors’ and defendants’ financial burdens. The KPMG case showed that the Fifth and Sixth Amendments and restrictions on prosecutors’ power could protect against interfering with contracts for indemnification, insurance, and advancement by using them as negative factors in sentencing. It is not clear, however, how far to take this approach. It is impracticable to read into the Sixth Amendment a right not only to counsel but also to a defense that can match the government’s resources.

Even assuming the practicality of adjusting the balance of power between prosecutors and defendants, the ideal balance is still unclear. The government often needs defendants’ cooperation in corporate criminal cases in order to prove liability. These cases turn on facts that are often uniquely within defendants’ control, particularly facts regarding mens rea. If criminal prosecutions of corporate agents benefit society by deterring corporate misconduct, then procedural rules and constitutional rights should not unduly undermine their effectiveness. However, as discussed below, these social benefits must be balanced against the prosecutorial agency costs they entail.

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75 See supra text accompanying note 31.
76 See generally Ribstein, supra note 1.
B. Changing Prosecutors’ Incentives

The revolving door and the politics of corporate crime arguably motivate prosecutors to cut ethical corners in order to bring and win prosecutions of high-profile corporate agents. One way to address prosecutorial agency costs is to weaken these pressures and thereby encourage prosecutors to weigh more heavily the costs of prosecutorial misconduct.

Blocking prosecutors’ routes into lucrative law firm jobs is one possible approach. Ex-prosecutors might be barred from transitioning into criminal defense work for a certain period after leaving the government, analogous to private sector non-compete agreements. This would at least decrease the present value of revolving-door benefits from prosecutorial decisions. It would also encourage prosecutors to stay on the job and give the government the benefit of their guidance, continuity, and long-term concern for the office’s reputation.

However, the costs of stopping the revolving door may outweigh the benefits. Barring prosecutors from private practice would make it harder to recruit competent attorneys willing to work for government wages, thereby reducing the quality of the prosecutorial candidate pool. Prosecutors who cannot exit into the private sector may be more receptive to political pressures which, as we have seen, can be just as socially costly as market pressures. Moreover, the revolving door can have positive incentive effects in subjecting prosecutors to the discipline of public opinion.

C. Changing Corporate Liability Rules

The best way to fix prosecutorial agency costs may be to change the nature of their cases themselves by reducing the criminalization of corporate conduct, and particularly of corporate agency costs. Rather than attempting to resolve the extensive debate on the efficiency of imposing criminal liability on firms and their agents, lawmakers should include prosecutorial agency costs in policymaking decisions. The following are some possible strategies.

1. Reducing Agent Liability and Penalties

The inherent nature of corporate agents’ crimes encourages prosecutorial abuse. There is only a vague line between criminal and non-criminal

77 Ethical rules restrict non-competition agreements in private law practice. See MODEL RULES OF PROF’L CONDUCT R. 5.6 (2004). However, public interest concerns with prosecutorial incentives arguably outweigh the arguments for ensuring client choice of counsel and commodifying law practice that support the application of this rule in private practice.
conduct in this context, partly because there is much less consensus here than with other areas of criminal law on the norms that underlie criminal liability. Moreover, the public does not always appreciate the economic and business considerations underlying corporate agents’ conduct as well as it appreciates the considerations underlying other areas of the criminal law. Laymen understand what is wrong with rape or murder better than they do the intricacies of the Generally Accepted Accounting Principles. The practical difficulty of proving exactly what agents did wrong further complicates liability in this context.

These problems pose challenges for prosecuting corporate agents. So far the law’s response has been to give prosecutors the tools necessary to prosecute these difficult cases, including broad liability standards. Such liability, however, increases both prosecutors’ discretion and the potential for error.

An alternative to giving prosecutors broad liability standards is to change the standards for establishing liability in cases involving corporate agents to address the factors that contribute to prosecutorial agency costs. This may include higher mens rea standards or prosecutorial reliance on clear rules rather than on vague conduct standards such as honest services mail fraud. Such changes might unacceptably reduce deterrence. The following discussion makes a more limited point that the standards of corporate agent liability should take into account the prosecutorial agency costs in connection with prosecuting this liability.

Prosecutorial agency costs may justify reducing the penalties for corporate agent misconduct. Draconian sentences like those given to Jamie Olis help prosecutors pressure defendants into accepting guilty pleas, even in some cases for crimes they did not commit. Sentences based on supposed damage caused collectively by corporate actors may not even approximate individual defendants’ culpability. As with liability standards, policymakers should take prosecutorial agency costs into consideration in deciding the appropriate penalty.

The law also could reduce prosecutorial pressure by clarifying the enforceability of agents’ contracts for indemnification and advancement.

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78 See supra text accompanying note 15.
82 See Wallace P. Mullin & Christopher M. Snyder, Should Firms Be Allowed to Indemnify Their Employees for Sanctions?, 26 J.L. ECON. & ORG. 30, 40 (2010).
This would fill the existing gap left by loose constitutional protection. However, this approach is unlikely to be very effective on its own. Firms may have good reasons not to fully finance their agents’ criminal defense and even stronger reasons than the general public to ensure that their agents are prosecuted for misconduct. Moreover, as long as firms are subject to prosecution they will have an incentive to cooperate with government prosecutions of their agents. No matter how explicit the policy against courts’ taking this type of cooperation into account in charging and sentencing firms, the firm’s cooperation can influence prosecutors’ and courts’ decisions. This influence suggests that enforcement officials may need to take the more drastic step discussed in the next section.

2. Reducing the Scope of Corporate Agent Criminal Liability

Another potential approach to mitigating prosecutorial agency costs is to reduce the scope of corporate agents’ criminal liability for acts committed in the course of their employment. Firms arguably have sufficient incentive, power, and information to properly allocate responsibility among their agents for harms for which corporations are responsible. Moreover, there are many problems associated with fixing criminal responsibility on corporate agents. There may be some situations in which, despite these problems, criminal liability of agents is appropriate. However, determining when to impose such liability should take into account the agency costs involved in prosecuting the offenses.

It is important to keep in mind that agents’ criminal liability is only one of several mechanisms that constrain agency costs in firms. For example, third parties can sue corporate agents for torts they commit, and shareholders can sue corporate agents derivatively through the corporation and directly under state and federal fraud laws. Agents’ criminal liability not only fails to compensate potential plaintiffs; it might even complicate the pursuit of civil liability. Even if agents’ criminal liability deters wrongdoing, it may also deter socially valuable risk-taking. Again, the question for present purposes is not whether criminalizing agency costs is overall good policy, but what role prosecutorial agency costs should play in this policy decision. The availability of other sanctions indicates that criminal liability is a close call in this context, and therefore that prosecutorial agency costs may matter at the margin.

83 See, e.g., United States v. Stein, 435 F. Supp. 2d 330 (S.D.N.Y. 2006), aff’d 541 F.3d 130 (2d Cir. 2008) (ruling that the government’s pressure violated defendants’ Fifth and Sixth Amendment rights).
84 For a discussion of corporate liability, see infra Part III.C.3.
85 See supra Part I.B.
Finally, it is worth noting that entity-only liability is currently the law’s approach to prosecutorial agency costs. Prosecutors face little individual responsibility for misconduct. Prosecutors’ offices may face supervisory liability for prosecutorial misconduct, but only under limited circumstances.

3. Reducing or Eliminating Corporate Criminal Liability

If agents can be criminally prosecuted, prosecutorial agency costs support reducing the scope of corporate criminal liability. Prosecutors can pressure potentially liable corporations to cut their employees loose and make them more vulnerable to prosecution in exchange for lower penalties or deferred prosecution agreements.

Reducing corporate criminal liability would not be enough in itself to protect agents from cost-based pressures to plea bargain. As discussed above, corporations have incentives apart from plea bargaining not to fund agents’ defense costs. Moreover, an inherent problem with corporate agent prosecutions is that the corporate context magnifies the scale of the agent’s conduct, prosecutors’ incentives to prosecute it and the costs of defense. Thus, the resource asymmetry between the government and criminal defendants is likely to remain even if the government cannot pressure corporations into supporting their employees. Nevertheless, reducing corporate criminal liability could significantly reduce prosecutors’ leverage and the agency costs that accompany this power.

CONCLUSION

The agency costs associated with prosecution of corporate crime are at least as consequential as those related to the crimes being prosecuted. This matters for at least two reasons. First, combining analyses of the two types of agency costs sheds light on how to appropriately constrain excessive or misguided corporate prosecutions. Second, prosecutorial agency costs bear on the extent to which the conduct of corporate agents should be criminalized at all given the weak constraints on prosecutorial conduct in enforcing

86 See supra Part II.C.
87 See Connick v. Thompson, 131 S. Ct. 1350 (March 29, 2011) (holding against office’s liability for failing to disclose exonerating evidence in absence of finding of policy of deliberate indifference to defendants’ constitutional rights as shown by a pattern of misconduct).
88 See Copland, supra note 29, at 10-11 (arguing that corporations should be held criminally liable only for the most serious and intentional crimes and only where specifically provided by statute). The focus of this discussion is not on the precise scope of corporate criminal liability but on how prosecutorial agency costs bear on the scope of criminal liability.
89 See id. at 1, 8.
the criminal law. The criminal laws may provide significant deterrence of corporate agents' misconduct that other mechanisms cannot fully supply. However, we should not assume that it is socially valuable to use the criminal laws to ensure totally loyal corporate agents unless we are ready to demand similar perfection from our prosecutors.