



Criminal Liability of Companies

U.S.A. - CALIFORNIA Morrison & Foerster LLP

CONTACT INFORMATION

Stephen P. Freccero
Morrison & Foerster LLP
425 Market Street
San Francisco, California 94105-2482
United States of America
Tel: 415.268.000 / Fax: 415.268.7522
sfreccero@mof.com
www.mof.com

1. General

1.1. Can a company be prosecuted in your jurisdiction in a similar way as an individual offender? Please explain the main differences, if any.

Yes. Companies operating in California are subject to the criminal laws of both the United States and the State of California. Under both U.S. (“federal”) and California (“state”) law, companies are considered legal “persons” and are subject to prosecution for all criminal offenses applicable to individuals (unless otherwise exempted by statute). *See* 18 U.S.C.¹ § 2510(6) (federal); *and* CAL. PENAL CODE² § 7 (state). The principal distinction between prosecutions of companies and individuals relates to the issue of punishment: unlike an individual offender, a company is not subject to imprisonment.

¹ “U.S.C.” stands for the “United States Code,” the uniform substantive law code of the United States applicable in all jurisdictions.

² “Cal. Penal Code” stands for the substantive criminal code that applies exclusively within the State of California.

1.2. Can other types of sanctions under criminal law been imposed on companies? Describe the major types of sanctions and their legal prerequisites.

There are two major forms of punishment that can be imposed on companies after conviction: (1) a fine in an amount determined by the offense statute, *see* 18 U.S.C. § 3571 (federal), **CAL. PENAL CODE** § 672 (state); and (2) an order to make financial restitution to any victim of the criminal conduct, *see* 18 U.S.C. § 3663 (federal), **CAL. PENAL CODE** § 1202.4 (state). A company must be formally charged and convicted of a crime before any criminal sanction is imposed. 18 U.S.C. § 3551 (federal); **CAL. PENAL CODE** § 1191 (state).

1.3. Are there any other kinds of sanctions in other fields of law which can be imposed on companies following the commission of an offence by its directors, managers or employees (e.g. fines, dissolution of a company, etc.)? Please describe the relevant sanctions and summarize the legal prerequisites.

In addition to these criminal sanctions, there are a number of potential collateral consequences that can result from criminal conviction. Criminal conviction may lead to “debarment,” where a company is precluded from participating in certain in federal and state-funded programs. *See, e.g.*, 42 U.S.C. § 1320a-7(a)-(b) (allowing for mandatory and permissive exclusion from participating in federal health care programs for certain criminal convictions, including prior conviction for health care fraud) (federal). Conviction can also result in the revocation of a business license or permit. *See, e.g.*, **CAL. H&S CODE**³ § 11106 (authorizing revocation of a permit upon conviction of federal or state offense) (state).

The commission of a criminal offense can also result in civil liability. Many criminal offense statutes expressly provide for civil monetary penalties in addition to criminal punishment. *See, e.g.*, 15 U.S.C. §§ 1; 12-27 (federal antitrust offenses); 42 U.S.C. § 7401 (federal pollution statute); 18 U.S.C. §§ 1961 *et seq.* (federal racketeering offenses); **CAL. BUS. & PROF. CODE**,⁴ §§ 16702 *et seq.* (state antitrust offenses), §§ 17200 *et seq.* (state unfair competition offenses), §§ 17500 *et seq.* (false advertising offenses). However, these sanctions may only be imposed on a company after separate civil proceedings.

³ Reference to California’s “Health & Safety Code” relating to the regulation of drugs, alcohol and certain medicines in California.

⁴ Reference to California’s “Business and Professions Code” relating to the regulation of business organizations in California.

2. Criminal Liability of Companies

2.1. What types of sanctions can be imposed on a company? What is the minimum/maximum punishment for each sanction? If the sanctions distinguish between certain types of offences please describe the sanctions for the most relevant offences or groups of offences.

As noted in 1.2 above, the principal criminal law sanctions on companies are fines and restitution. The maximum fine that can be imposed for a specific crime is generally established by statute. *See, e.g.*, 18 U.S.C. § 1031 (establishing a maximum fine of \$10,000,000 for conviction of multiple acts of fraud against the U.S.) (federal); *and* **CAL. PENAL CODE** § 186.10 (establishing a maximum fine of \$500,000 or five times the value of the property, whichever is greater, for a second or subsequent violation of money laundering statute) (state). In the absence of any specific maximum amount specified in the offense statute, federal law provides that companies may be fined any amount up to twice the amount of the pecuniary gain or loss from the offense, or a maximum of \$500,000 for serious crimes. 18 U.S.C. § 3571. Under state law, if there is no maximum fine set by statute, then a company is subject to a fine of up to \$10,000 per offense. **CAL. PENAL CODE** § 672.

The court determines the amount of any fine after conviction. Under federal law, the fine is calculated based on either the victim's loss or the company's gain multiplied by a factor set forth in the United States Sentencing Guidelines ("U.S.S.G."). *See* 18 U.S.C. §§ 3571-72 (federal statutes outlining factors to be considered). Under state law, the court in its discretion determines the appropriate fine, limited only by the statutory maximum. *See, e.g.*, **CAL. PENAL CODE** § 186.11(e) (7) (imposition of fines for fraud-related crimes) (state).

The amount of restitution is determined by the pecuniary or economic loss suffered by the victim of the offense. *See* 18 U.S.C. §§ 3663, 3663A (federal); **CAL. PENAL CODE** § 1202.4 (state).

In certain circumstances, additional sanctions may be imposed on a company. For example, a company may be placed under the supervision of the court system for a specified term during which time period it can be restrained from conducting certain business activities or compelled to take certain remedial action. *See* 18 U.S.C. § 3563 (federal statute authorizing terms of probation); **CAL. PENAL CODE** § 1203 (state statute authorizing terms of probation). In addition, a company can have property forfeited if it was used in the commission of an offense, or it represents the proceeds of unlawful activity. *See* 18 U.S.C. § 982 (federal forfeiture statute); **CAL. PENAL CODE** § 186 (state forfeiture statute).

2.2. What are the legal requirements for each type of sanction?

All criminal law sanctions require that the underlying federal or state crime be proven "beyond a reasonable doubt." *In re Winship*, 397 U.S. 358, 364 (1970) (due process

requires that prosecutor prove every element of the charged crime beyond a reasonable doubt). However, sentencing factors, such as the amount of loss associated with a crime for purposes of calculating a fine or restitution order, may be proven at a sentencing hearing by a lesser standard, unless doing so would increase the criminal penalty beyond the prescribed statutory maximum for the offense of conviction. *Apprendi v. New Jersey*, 530 U.S. 466, 490-92 (2000).

2.3. Is the prosecution of a company confined to certain types of offences or to offences committed by certain hierarchy of company staff? If yes, please explain in more detail.

No.

2.4. How will acts (or omissions) of individuals (directors, managers, employees) be attributed to a company? Can acts or omissions be attributed if the individual violated only internal (but not statutory) rules or regulations?

A company can be held criminally responsible for the illegal acts of its directors, managers and employees under the common law theory of *respondeat superior*. Accordingly, a company can be prosecuted for any illegal acts of an employee that were (1) within the scope of employment and (2) intended, at least in part, to benefit the company. *See, e.g., United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1004 (9th Cir. 1972) (federal), and *W.T. Grant Co. v. Superior Court*, 23 Cal. App. 3d 284, 287 (1972) (state).

The violation of internal company rules and regulations is not sufficient in and of itself to constitute a crime, unless the same violation (*e.g.*, policy requiring disclosure of hazardous condition) also constitutes a statutory offense. *See, e.g., CAL. PENAL CODE* § 387 (making it a criminal offense for a company or its “manager” to conceal a danger subject to regulatory authority) (state).

2.5. How will mens rea of the company be established?

The *mens rea* of any culpable employee or agent is imputed to the company. Under federal law, a company is presumed to possess the combined knowledge of all its individual employees under the “collective knowledge doctrine.” *United States v. Bank of New England, N.A.*, 821 F.2d 844 (1st Cir. 1987). However, a company can only be convicted of a “specific intent crime” — *i.e.*, a crime that requires a culpable state of mind greater than that simply required to commit the *actus reus* — if some agent of the company satisfies this heightened *mens rea* standard. *See, e.g., W.T. Grant Co. v. Superior Court*, 23 Cal. App. 3d 284 (1972) (state).

2.6. Is there a strict liability of a company for certain kinds of offences for which mens rea is not required? Please describe for which kind of offences mens rea is necessary and for which not.

Both federal and state law recognizes certain “strict liability” offenses that do not require a *mens rea*. These offenses are usually characterized as less serious “regulatory” crimes that involve public welfare and include offenses such as: (1) harm to wildlife and natural resources, *see, e.g.*, 16 U.S.C. § 707(a) (federal strict liability crime for killing migratory birds); **CAL. F&G⁵ CODE** §§ 650, 12002 (state strict liability crimes related to discharging pollutants into waters); (2) misbranding food or medicines, *see, e.g.*, 21 U.S.C. §§ 301 *et seq.* (federal strict liability crimes related to food and medicines); (3) business license activities. *See, e.g., People v. Baumgart*, 218 Cal. App. 3d 1207 (1990) (conviction for sale of unqualified securities) (state)

Most crimes, however, require proof of an intentional or “knowing” act, often coupled with a “specific intent” to defraud or harm. *See, e.g.*, 18 U.S.C. § 1031 (criminalizing schemes executed with the intent “to defraud the United States”) (federal); **CAL. PENAL CODE** § 186.9 (criminalizing financial transactions with the “specific intent” to facilitate criminal activity) (state). A crime is committed “knowingly” if the offender is aware of what he is doing and does not act (or fails to act) through mistake or accident. However, the offender need not know that the acts or omissions were unlawful. *See United States v. Santillan*, 243 F.3d 1125, 1129 (9th Cir. 2001) (federal); **CAL. PENAL CODE** § 7 (statutory definition of “knowingly”) (state).

Convictions for tax violations require proof that the violation was “willful,” that is, that the acts were done voluntarily and intentionally and with the purpose of violating a known legal duty. *Cheek v. United States*, 498 U.S. 192, 199 (1991) (federal); *People v. Hagen*, 19 Cal. 4th 652, 666 (1998) (state).

2.7. Is it necessary to identify and/or convict the individual offender in order to prosecute a company?

No. Neither federal nor state law requires “consistent verdicts,” and accordingly, even if the individual offender is acquitted, the company may nonetheless be convicted. *See United States v. Hughes Aircraft Co., Inc.*, 20 F.3d 974, 977-78 (9th Cir. 1994) (federal); **CAL. PENAL CODE** §§ 970, 1160 (providing for separate verdicts in a case with multiple criminal defendants) (state).

2.8. What additional defenses (except of lack of offence) can a company raise?

Because companies are considered persons under the law, any defenses available to an individual are generally available to a company. Accordingly, a company may rely on all constitutional and statutory defenses (such as jurisdictional defects or because the prosecution is barred by the statute of limitations), or assert any defense that negates the *mens rea* of the culpable employee. In addition, as noted in answer to question 2.4,

⁵ Refers to California’s “Fish & Game Code” relating to the regulation of wildlife within the state.

a company cannot be responsible for the acts of employees if they do not meet the agency standards of *respondeat superior*. In certain circumstances, a company can assert that it justifiably relied on administrative rulings authorizing its conduct (as in the case with certain environmental crimes).

In limited circumstances, dissolution of the company may be a defense to prosecution. However, successor corporations can be held responsible for the crimes of the predecessor company. *Melrose Distillers v. United States*, 359 U.S. 271, 274 (1959) (dissolution of subsidiaries did not abate antitrust prosecution when entities became divisions of parent corporation).

2.9. Can a company avoid punishment if it is sufficiently organized, has duly instructed its directors, managers or employees and has taken reasonable care to exert control on its directors, managers or employees? What extent or organizational requirements and control are necessary to avoid conviction?

No. Company policies and controls aimed at preventing illegal conduct, and even explicit instructions to employees not to engage in certain conduct, generally do not establish a legal defense to criminal charges. *See, e.g., United States v. Potter*, 463 F.3d 9, 25-26 (1st Cir. 2006) (federal). However, such actions may be helpful and even determinative in persuading the prosecution not to exercise its discretion to charge the company with criminal wrongdoing.

2.10. Can certain kinds of sanctions be executed during the investigative phase of a criminal proceedings (e.g. preliminary seizure of bank accounts, attachment of claims)?

Yes. Upon application of the prosecutor, both federal and state courts may restrain assets *pendente lite* to preserve them for future disposition. *See, e.g.,* 18 U.S.C. § 1963(d) (authorizing restraining orders against property subject to forfeiture under federal racketeering laws); CAL. PENAL CODE § 186.6 (authorizing restraining orders to preserve property subject to forfeiture under state profiteering laws).

2.11. Can both the individual offender and the company be convicted for the same offence?

-

2.12. Can a parent/group company be prosecuted for offences being committed within a subsidiary?

Yes. Federal law permits prosecution of the parent if it exercises sufficient control over the subsidiary. *United States v. Bestfoods*, 524 U.S. 51, 62-65 (1998) (federal). Just as a corporation is responsible for the criminal acts of its human agents when they act for the corporation, a subsidiary is sometimes treated as the legal agent of the parent. *United States v. Wilshire Oil Co.*, 427 F.2d 969, 974 (10th Cir. 1970) (federal).

3. Criminal Sanctions on a Company

3.1. What other types of sanctions but a criminal punishment can be imposed on a company? Please describe the types of sanctions and their legal requirements.

As noted in the answer to 1.3, companies can also be subject to civil liability. The primary sanctions are monetary penalties and injunctive relief.

3.2. Is the imposition of these sanctions confined to certain types of offences? Describe the most relevant sanctions and types of offences?

Yes. Civil sanctions must have a basis in statutory law. The major areas of government enforcement activity that contain both criminal punishment and civil monetary penalties include antitrust or unfair competition violations, government fraud, environmental or pollution regulations, and racketeering or criminal enterprise violations. All of these statutes provide for the imposition of civil monetary penalties in addition to potential criminal sanctions. See answer to 1.3.

3.3. What defenses can a company raise against these offences?

See answer to question 2.8

3.4. Can such sanctions be executed during the investigative phase of a criminal proceedings?

Yes. To the extent that there are separate civil claims made against a corporation by private parties or government agencies, those proceedings can go forward during a criminal investigation. However, it is common for both government agencies and the company to request a stay in civil proceedings pending the outcome of any criminal investigation or prosecution.

4. Procedural Issues in Cases of Corporate Liability

4.1. Does the prosecution have discretion to prosecute or not a company? Which aspects will the prosecution take into account?

Yes. Under both federal and state law, the decision to prosecute a corporation depends ultimately on the discretion of the prosecutor. See, e.g., *Newman v. United States*, 382 F.2d 479, 480 (D.C. Cir. 1967) (charging decision is discretionary); *Nader v. Saxbe*, 497 F.2d 676, 679 n. 18 & n. 19 (D.C. Cir. 1974) (discretion exists by virtue of the prosecutor's status as a member of the Executive Branch) (federal); *People v. Municipal Court (Pellegrino)*, 27 Cal. App. 3d 193 (1972) (state).

For federal crimes, this prosecutorial discretion is guided by various policy statements issued by the U. S. Department of Justice. The most recent policy formulation⁶

⁶ See Memorandum of Deputy Attorney General Paul J. McNulty, *Principles of Federal Prosecution of*

identifies a number of different factors to be taken into account by prosecutors, including: (i) the strength of the evidence; (ii) the deterrent effect of a prosecution; (iii) the pervasiveness of the wrongdoing inside the company; (iv) remedial actions taken by the company; (v) the company's history of similar conduct; (vi) the existence and adequacy of the company's preexisting compliance program; (vii) collateral consequences of the prosecution, including harm to innocent shareholders; and (viii) the company's level of cooperation with the government during the investigations.

For state crimes, the exercise of prosecutorial discretion is guided by the formal or informal policies established by the local prosecuting authority and as a result can vary significantly within the state. Nonetheless, many of the same federal policy factors play a role in the exercise of discretion by state prosecutors.

4.2. At what stage during an investigation/proceeding does a company have the status as a suspect or similar status?

Neither federal nor state law recognizes a formal investigative stage of criminal proceedings, and there is therefore no legal requirement that a company be notified that it is a suspect in an investigation.

However, most federal — and some state — investigations are conducted with the aid of a Grand Jury, a group of citizens empanelled by the judiciary with the power to compel testimony and the production of documents. As a matter of policy, a federal prosecutor may notify a company that it is a “target” or “subject” of a Grand Jury investigation, but there is no legal requirement of notification. There is no equivalent state prosecution policy.

4.3. Does a company have the rights to remain silent (nemo tenetur se ipsum accusare), to refuse production of documents, to deny access to company site without search warrant, to refuse testimony, to answer questions or to any other suspects rights? Who exerts these rights if investigations are made against the company's directors?

A company itself does not have a “right to remain silent” (the privilege against self-incrimination contained in the Fifth Amendment to the U.S. Constitution). See *Braswell v. United States*, 487 U.S. 99, 102 (1988) (federal); *Avant! Corp. v. Superior Court*, 79 Cal. App. 4th 876, 883-86 (2000) (state). As a consequence, a company cannot prevent its employees or agents from providing testimony and does not have a right to refuse to produce documents. However, any constituent member of a company, including its directors, has a right to refuse to testify if doing so could incriminate them personally or subject them individually to the threat of criminal prosecution.

Business Organizations, December 12, 2006 (“McNulty Memo”). The McNulty Memo is a non-binding policy statement regarding the prosecution of companies that provides guidance to federal prosecutors throughout the United States.

4.4. When will a company be informed that it is or can become prosecuted?

A company is formally notified that it will be prosecuted by way of an official written accusatory document, called variously an “indictment,” “information,” or “complaint.” The document identifies the specific offense alleged, the identity of the accused, and is filed with the court. *See* FED. R. CRIM. P. ⁷ 7(c)(1) (an indictment or information is “a plain, concise, and definite written statement of the essential facts constituting the offense charged and [which] must be signed by an attorney for the government.”) (federal); CAL. PENAL CODE § 950 (an accusatory pleading must contain title of the court, the names of the parties and a “statement of the public offense or offenses charged therein”) (state).

4.5. Can the directors, managers or employees be witness in proceedings against a company? Does this also apply if the directors, managers or employees are suspects themselves?

Yes, as noted more fully in the answer to 4.3.

4.6. Will there be a joint proceeding against the company and the individual offender?

Generally, two or more parties may be jointly prosecuted in a criminal action if they participate in the same act or series of acts constituting an offense. FED. R. CRIM. P. 8(b) (federal); CAL. PENAL CODE § 1098 (state). However, there is no rule that requires a joint prosecution and the decision is generally left to the discretion of the prosecutor.

4.7. Does the proceeding against a company differ from that against an individual suspect? If yes, describe the elemental differences.

No.

5. Procedural Issues on Other Criminal Sanctions

5.1. Does the prosecution have discretion to impose or not a sanction on a company? Which aspects will the prosecution or court take into consideration?

Yes, except that under both federal and state law, an order of restitution is required whenever a victim has suffered economic harm as a result of the crime. 18 U.S.C. § 3663A (federal); CAL. PENAL CODE § 1202.4 (state).

See also the answers to questions 2.1 and 4.1.

⁷ Refers to the “Federal Rules of Criminal Procedure” which apply to all federal criminal proceedings throughout the United States.

5.2. Does the company, have the status of a suspect or a similar status and at what stage in proceedings?

See answer to question 4.2.

5.3. When will the company be informed that the prosecution is considering to impose sanctions or have sanctions imposed?

See answer to question 4.4.

5.4. Which procedural rights does a company have when it is at risk that sanctions might be imposed?

As a legal “person,” a company is entitled to the same procedural rights as an accused individual. These rights include the right to counsel, a right to be present at all proceedings and examine the evidence, the right to present and cross-examine witnesses, and a right to a public, speedy and fair trial by an impartial jury.

5.5. Will there be joint proceedings against the company and the individual offender?

See answer to question 4.6

5.6. Does the proceeding against a company differ from that against an individual suspect? If yes, describe the elemental differences.

See answer to question 4.7.

6. Criminal Liability of Directors or Managers

6.1. Can directors or managers be criminally held liable for offences committed by other individual directors, managers or employees? Which legal concepts apply in your jurisdiction?

Yes. In certain limited circumstances, a director or manager of a company may be held criminally liable for “strict liability” or regulatory offenses committed by the company. See *United States v. Park*, 421 U.S. 658 (1975) (president and chief executive officer of a national food retailer individually charged with violations of the federal Food, Drug and Cosmetic Act) (federal); *People v. Conway*, 42 Cal. App. 3d 875 (1974) (president of automobile dealership criminally convicted for the false advertising statements of his employees) (state).

6.2. What are the legal requirements for a criminal liability of directors and managers for offences committed by others?

The manager or director of a company may be held individually responsible if by virtue of his position within the company he has responsibility or authority either to

prevent or correct the violation, and yet fails to do so. *See United States v. Park*, 421 U.S. 658 (1975) (federal); *People v. Conway*, 42 Cal. App. 3d 875 (1974) (state).

California also has a statute entitled the “Corporate Criminal Liability Act” which makes it a crime for a company or a manager to conceal a danger subject to regulatory authority. **CAL. PENAL CODE § 387.**

6.3. Does a criminal liability arise only from the fact that another director, manager or employee was not adequately selected, instructed, supervised or the company not adequately organized?

Yes.

6.4. What recommendations do you have to exclude or minimize criminal liability risks of directors of a company?

A company operating in California, particularly one that is regulated by statute qualifying as “public safety” or “regulatory law,” should work closely with counsel to plan and implement corporate compliance programs sufficient to prevent unlawful activities and to detect and remedy any violations that do occur. The prompt detection of potential offenses and swift remedial action, along with voluntary disclosure to the authorities and cooperation in any investigation, can in many circumstances minimize the risk of criminal prosecution.